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No. 84-623

In the Supreme Court of the United States

October Term, 1984

CINCINNATI BELL TELEPHONE COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

ON APPEAL FROM
THE SUPREME COURT OF OHIO

APPENDIX TO JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

Opinion of the Ohio Supreme Court (July 25, 1984) A1
Entry on Rehearing of The Public Utilities Commission of Ohio (March 9, 1983) A25
Opinion and Order of The Public Utilities Commission of Ohio (January 7, 1983) A36
Decision of the United States Court of Appeals for the Fourth Circuit in *Virginia State Corporation Commission v. FCC, et al.*, (Motion For Rehearing En Banc denied) 737 F.2d 388 (4th Cir. 1984) A131
Memorandum Opinion and Order of the Federal Communications Commission, 48 Fed. Reg. 2324 (January 18, 1983) A158
Judgment Entry of the Ohio Supreme Court (July 25, 1984) A187
Notice of Appeal to the Supreme Court of the United States (July 25, 1983) A188
Segments of Cincinnati Bell Telephone Company's Brief in the Ohio Supreme Court (May 16, 1983) A191
Segments of Cincinnati Bell Telephone Company's Reply Brief in the Ohio Supreme Court (September 12, 1983) A200
Letter from Mark H. Longenecker, Jr. to James Kelly, Clerk of the Ohio Supreme Court A204

APPENDIX

OPINION OF THE OHIO SUPREME COURT

(Entered: July 25, 1984)

Nos. 83-392, 83-733 & 83-1595

THE SUPREME COURT OF OHIO

THE STATE OF OHIO, CITY OF COLUMBUS

CINCINNATI BELL TELEPHONE COMPANY,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF OHIO *et al.*,
Appellees.
[Two Cases]

OFFICE OF CONSUMERS' COUNSEL,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF OHIO *et al.*,
Appellees.

[12 Ohio St. 3d 280]

Public Utilities Commission: Commission may establish whole life depreciation schedules notwithstanding FCC order, when—Commission's orders concerning ENFIA usage and cost of equity lawful—Funds deposited in trust account distributed to customers, when.

APPEALS from the Public Utilities Commission of Ohio.

This proceeding originated on November 6, 1981, when Cincinnati Bell, Inc., now Cincinnati Bell Telephone Company (hereinafter "CBT"), filed a notice of intent to file an application for an increase in rates charged to its Ohio customers. By entry dated November 25, 1981, the commission approved CBT's proposed test year consisting of twelve months ending August 31, 1982, with a date certain of February 28, 1982.

During the pendency of the application, the Office of Consumers' Counsel (hereinafter "OCC") filed for and received leave to intervene in the proceedings. Public hearings commenced on October 14, 1982, and concluded on November 16, 1982.

On January 7, 1983, the commission issued its opinion and order which provided, *inter alia*, for: (1) utilization of CBT's proposal to implement remaining life depreciation accrual rates in accordance with a recent ruling by the Federal Communications Commission[1] (hereinafter "FCC"), attempting to preempt all state utilities commissions from using depreciation accrual rates in intrastate ratemaking other than those prescribed by the FCC; (2) adoption by the commission of CBT's separation factors which account for exchange network facilities for interstate access ("ENFIA") usage at 3,402 minutes per month. (ENFIA usage is that portion of interstate usage typically associated with specialized common carriers such as MCI or SPRINT who use CBT's facilities to originate and terminate toll-like calls); (3) adoption of a 14.83 percent cost of equity based upon CBT's bond, stock and financial stability ratings; and (4) that an adjustment resulting from a decrease in local service revenues estimated by CBT at $2,243,000 be denied.

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1. OCC and CBT were granted leave to intervene in case Nos. 83-392 and 83-733, respectively, as appellees.

On February 7, 1983, CBT and OCC filed applications seeking a rehearing. While OCC's application was granted in part, CBT's was denied. On March 9, 1983, the commission issued its rehearing order concluding: (1) that CBT must utilize whole life depreciation accrual rates instead of the remaining life rates ordered by the FCC, until a court of competent jurisdiction holds otherwise; and (2) that the ENFIA usage figure be adjusted from 3,402 minutes to 4,474 minutes to reflect a September 1982 FCC order adopting that level of ENFIA usage. Case Nos. 83-392 and 83-733 represent CBT's and OCC's respective appeals from the commission's March 9, 1983 entry on rehearing.[2]

On the same day the commission issued its order on rehearing, CBT filed with this court in Case No. 83-392 an application for a stay of the commission's rehearing order pending final resolution of the issues presented herein. On March 16, 1983, the stay was granted contingent upon CBT's payment into a trust account of charges in excess of those allowed by the rehearing order. See R.C. 4903.16.

Thereafter, the commission issued an entry dated April 6, 1983 in accordance with R.C. 4903.18, requiring CBT to maintain accurate accounts of the excess amounts being charged during the pendency of this appeal. In addition, and because the evidence before the commission led it to conclude that the revised rates due to the stay did not conform to the March 9, 1983, entry on rehearing, a hearing was scheduled for April 19, 1983, to resolve the ENFIA issue so that CBT's accounts were properly maintained.

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2. The stay was modified on April 7, 1983 and again on September 13, 1983, thereby increasing CBT's trust deposits.

The hearing commenced as scheduled but no testimony was presented due to the parties' request to negotiate a settlement. The hearing resumed April 25, 1983, at which time OCC, CBT and the commission's staff presented testimony. Following that hearing, CBT filed two motions to present additional evidence from the FCC concerning ENFIA usage. Both motions were denied; however, a motion by the staff to present additional evidence not yet available at the April 25, 1983 hearing was sustained.

On June 29, 1983, the commission entered an order revising a previous computational error. Furthermore, the commission ordered that CBT's overall rate increase, including the revised ENFIA figure, should be $10,600,000. Accordingly, CBT was ordered to prepare and file tariffs in that amount. In Case No. 83-1595, CBT objects to the denial of its additional evidence by the commission. OCC was granted leave to intervene as appellee.

The causes, having been consolidated as arising out of a single rate proceeding, are now before this court on appeals as of right.

Messrs. Frost & Jacobs, Mr. Mark H. Longenecker, Jr., Mr. David C. Horn, Mr. Earl R. Huffman and *Mr. William D. Baskett, III,* for Cincinnati Bell Telephone Co.

Mr. Anthony J. Celebrezze, Jr., attorney general, *Mr. Robert S. Tongren, Mr. Jonathan L. Heller* and *Mr. Martin J. Marz,* for Public Utilities Commission.

Mr. William A. Spratley, consumers' counsel, *Ms. Janine L. Migden, Mr. Lawrence F. Barth* and *Mr. Bruce J. Weston,* for Consumers' Counsel.

Messrs. Schneider, Prohaska & Sams and *Mr. J. Raymond Prohaska,* urging reversal for *amicus curiae,* Ohio Telephone Assn. in case No. 83-392.

Per Curiam.

Case No. 83-392

In its first three propositions of law, CBT challenges the validity of the commission's March 9, 1983 entry on rehearing whereby CBT was ordered to establish whole life depreciation schedules. CBT maintains that the right of state public utility commissions to prescribe their own depreciation rates for intrastate ratemaking purposes was preempted by the FCC on January 6, 1983. On that date, the FCC released a memorandum opinion and order in *In re Amendment of Part 31*, 92 F.C.C. 2d 864, which reads in pertinent part as follows:

"The question presented in the reconsideration petition is a clearly delineated controversy over whether Section 220(b) [, Title 47, U.S. Code,] preempts state depreciation prescriptions that are inconsistent with the rates prescribed for classes of property by this Commission, or, whether Section 2(b)(1) [, Section 152(b)(1), Title 47, U.S. Code,] or Section 221(b) [, Title 47, U.S. Code,] reserve[s] to the states the right to prescribe their own depreciation rates for intrastate regulatory purposes." *Id.* at 867.

Continuing, the FCC made the following finding of fact in the preemption order:

"It is clear that unless telephone plants, including that portion subject to allocation to the intrastate jurisdiction, is depreciated at a reasonable rate, improperly timed capital recovery will occur. Indeed, in an increasingly competitive environment, it is possible that improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital. Moreover, the extent of state action attempting to prevent carriers from utilizing our deprecia-

tion prescriptions places substantial burdens on carriers and could well impair their ability to raise the investment capital they will need to fully compete in the continually evolving competitive telecommunications marketplace. Such a result could undermine the achievement of the Commission's objective to develop policies that will engender a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices." *Id.* at 877.

The FCC then concluded that "* * * the most logical and reasonable interpretation of Section 220(b) of the * * * [Federal Communications Act of 1934] is that where the * * * [FCC] prescribes depreciation rates for classes of property, state commissions are precluded from departing from those rates." *Id.* at 879.

CBT initially argues that principles of *res judicata* prohibit the commission from deviating from the FCC's preemption order. CBT predicates this argument on the commission's presence at the FCC proceeding which preceded the issuance of the preemption order and contends that *res judicata* can attach to an administrative proceeding.

CBT is correct in its assertion that *res judicata* can apply as a result of a prior administrative proceeding. *Superior's Brand Meats, Inc. v. Lindley* (1980), 62 Ohio St. 2d 133 [16 O.O. 3d 150]. However, it is the nature of the administrative proceeding which is determinative of whether the doctrine applies. Generally, there are two types of administrative hearings—adjudicative and legislative. Under adjudicatory actions, *res judicata* will attach. However, where an administrative proceeding involves legislative or rulemaking functions, *res judicata* does not apply. *State Corp. Comm. of Kansas v. Wichita Gas Co.* (1934), 290 U.S. 561, 569.

The record demonstrates that the FCC order was promulgated under the guise of that agency's rulemaking authority. No hearings were conducted and no expert testimony was elicited. Instead, comments were simply filed for consideration by the FCC without cross-examination or confrontation. We conclude that the FCC order was legislative, as opposed to adjudicative, in nature and therefore *res judicata* is inapplicable.

Alternatively, CBT contends that the commission erred in failing to abide by the FCC's order, and that neither this court nor the commission has jurisdiction to review the order and rule on its validity. The federal circuit courts of appeals have authority to enjoin, set aside, suspend or to determine the validity of any order of the FCC. Section 2342, Title 28, U.S. Code. The commission, however, does not seek to have the subject order enjoined, suspended, set aside, or invalidated. This court does, however, have jurisdiction to review final orders of the Public Utilities Commission. R.C. 4903.13.

In *Southwestern Bell Tel. Co. v. Arkansas Pub. Serv. Comm.* (Mar. 30, 1984), E.D. Ark. No. LRC 84-247, unreported, the court was presented with facts closely analogous to the case at bar. Therein, Southwestern Bell sued for declaratory judgment and preliminary and permanent injunctive relief for the failure of the Arkansas Public Service Commission to prescribe depreciation rates in conjunction with the FCC preemption order. In granting summary judgment against Southwestern Bell, the court stated:

"* * * The Federal Communications Commission was established by the Communications Act of 1934, 47 U.S.C. § 151 *et seq.*, to regulate interstate and foreign communication. Congress expressly limited its jurisdiction,

excluding regulation of intrastate communication. 47 U.S.C. § 152(b)(1). The FCC is authorized to determine depreciation rates for interstate carriers under 47 U.S.C. § 220(b). The FCC is authorized to exempt carriers such as the plaintiff from any of its accounting requirements where they are concurrently regulated by state regulatory commissions. 47 U.S.C. § 220(h). Within a nine month period, the FCC interpreted § 220(b) to deny its jurisdiction over establishing depreciation rates for intrastate ratemaking, and then to grant such jurisdiction. *Compare Amendment of Part 31,* 89 F.C.C. 2d 1094 (1982) with *Amendment of Part 31,* 92 F.C.C. 2d 864 (1983) ('Preemption Order').

"The Court has reviewed the FCC's analysis of the legislative history and is unpersuaded that the FCC has jurisdiction to determine intrastate depreciation methods. Although § 220(b) is not expressly limited to interstate depreciation methods, this must be implied. The 1934 act left the door open for the FCC to ask Congress for additional authority under 47 U.S.C. § 220(j). In light of the express FCC jurisdictional *limitations* imposed by Congress, the FCC's interpretation of expanding jurisdiction is a non sequitur. The logic of expanding into intrastate jurisdictional matters in the name of 'rapid, efficient, nation-wide, world-wide wire and radio communication service with adequate facilities at reasonable charges' could, theoretically, allow the FCC to bootstrap itself into preempting *all intrastate* ratemaking determinations. 92 F.C.C. 2d at 876 (citing 47 U.S.C. § 151). If the FCC wishes to have this authority, it should seek express congressional approval. The Court finds the FCC preemption of intrastate depreciation methods to be ultra vires and will not enforce it for the plaintiff.

"Some mention has been made that only a court of appeals may invalidate an FCC order pursuant to 28 U.S.C. § 2342. However, 28 U.S.C. § 2342 is inapposite since this proceeding is not 'any proceeding to enjoin, set aside, annul or suspend any order' of the FCC, making 47 U.S.C. § 402(a) applicable. Since the FCC is not a party, it will have not affect [sic] upon it. Further, determination of the issue is merely incidental to this lawsuit over which this Court has ample jurisdictional basis. If the FCC wishes to enforce its order, then it should take the appropriate steps."

We are in agreement with the court's analysis, and, accordingly, we conclude that the depreciation methodology adopted by the commission in its March 9, 1983 order on rehearing is reasonable and lawful.

CBT next argues that the commission erred when on rehearing it considered additional evidence concerning ENFIA usage when CBT and other parties to the rate case did not have an opportunity to present their positions concerning such additional evidence. Although ENFIA usage is within the jurisdiction of the FCC, this factor is nevertheless considered by the state utilities commissions for purposes of determining the appropriate separation factors to allocate the local exchange carrier's plant between intrastate and interstate jurisdictions. Accordingly, in its initial opinion and order, the commission adopted an ENFIA usage figure of 3,402 minutes. Subsequently, in its application for rehearing, OCC brought to the commission's attention a September 1982 FCC order modifying the ENFIA usage figure deemed appropriate for allocating separation factors from the 3,402 minutes level to 4,474 minutes. On rehearing, the commission took administrative notice of the revised FCC figure relating to ENFIA usage and adopted that figure without providing

CBT an opportunity to present its position through additional testimony or cross-examination. As such, CBT contends the ENFIA modification was unlawful because no testimony was taken on the subject at the rehearing. CBT was denied an opportunity to "explain or rebut" the September 1982 FCC order upon which the commission revised the ENFIA usage; nevertheless, CBT fails to explain how it has been prejudiced by the denial. Initially, CBT acknowledges that ENFIA service is within the FCC's jurisdiction. Additionally, although the FCC order was issued one month after the close of CBT's test year, it was made retroactive to May 1, 1982, clearly within the test year. Thus, even though CBT was unable to "explain or rebut" the latest figures upon which the commission based its ENFIA calculations, CBT was not shown to have been prejudiced thereby. In *Worthington Hills Civic Assn. v. Pub. Util. Comm.* (1976), 45 Ohio St. 2d 11, 12-13 [74 O.O. 2d 40], this court stated that it " '* * * will not reverse an order of the commission as unreasonable or unlawful because of an error of the commission, if such error did not prejudice the party seeking such reversal.' *Cincinnati v. Pub. Util. Comm.* (1949), 151 Ohio St. 353 [39 O.O. 188], paragraph six of the syllabus."

CBT further argues that the commission's failure to adjust the cost of equity after it reversed its position on rehearing by adopting whole life depreciation as opposed to remaining life depreciation constitutes reversible error and violates due process of law. CBT predicates its argument on language which appears in the commission's initial opinion and order stating that the adoption of remaining life depreciation rates was a consideration in determining the rate at which to set the utility's cost of equity component.

Contrary to the contentions of CBT, the depreciation issue was the last of many considerations weighed by the

commission when determining CBT's cost of equity. This is exemplified by the commission's initial opinion and order which provides in pertinent part:

"* * * [W]e have generally begun our deliberations [concerning cost of equity] at the midpoint of the range [between 14.59% and 15.55%], and then moved in one direction or another if the particular record under review evidences facts which we, in our discretion, believe should be taken into consideration. * * * A cost of equity lower than the midpoint is supported by the fact that Cincinnati Bell has an Aaa bond rating, has the highest stock safety and stability ratings awarded by *Value Line,* has the second highest *Value Line* rating for overall corporate financial strength, does not rely upon frequent public stock offerings to generate funds, and will experience less risk in the future as a consequence of the enhanced possibility of all capital recovery resulting from the Commission's adoption of vintage group remaining life depreciation accrual rates. * * * Selecting a cost of equity above the midpoint, by contrast, is supported by the excellent service the Applicant provides and the uncertainty surrounding the impending divestiture * * * After assessing these considerations, we believe that the factors justifying a cost of equity lower than the midpoint outweigh the countervailing factors. We accordingly find that * * * 14.83 percent, is the appropriate cost of equity."

"* * * [T]his court has consistently deferred to the expertise of the commission in determining an appropriate rate of return unless such determination is 'manifestly against the weight of the evidence and * * * so clearly unsupported by the record as to show misapprehension or mistake or willful disregard of duty.'" *Consumers' Counsel v. Pub. Util. Comm.* (1980), 64 Ohio St. 2d 71, 79 [18 O.O. 3d 302], quoting *C&SOE v. Pub. Util. Comm.* (1979), 58 Ohio St. 2d 120 [12 O.O. 3d 122].

In the present cause, the commission's opinion and order weighs many factors in reaching CBT's cost of equity. Contrary to CBT's contentions, its cost of equity was not based solely upon the establishment of remaining life depreciation rates. Additionally, although CBT seeks to have this court order yet another hearing at which it could argue for a higher cost of equity as a result of the establishment of whole life depreciation rates, this precise argument was already placed before the commission by CBT at the initial hearing in this action. CBT argued that if remaining life depreciation rates were adopted, a lower rate of return would be necessary than if whole life depreciation rates were utilized. Given the commission's expertise in this area, coupled with its broad discretion, *Consumers' Counsel, supra,* it must be concluded that when whole life depreciation rates were adopted on rehearing, the commission appropriately weighed this adjustment against CBT's cost of equity and concluded that an adjustment was not necessary.

Finally, CBT argues that the commission erred when it failed to adjust the company's local service revenues in conjunction with the filing of updated materials.

Pursuant to R.C. 4901.13, the commission is empowered to promulgate rules to govern its proceedings and to regulate the mode and manner of all valuations, tests, inspections, investigations and hearings relating to parties who appear before it. Accordingly, the commission has adopted "Standard Filing Requirements" which provide in pertinent part:

" 'Projected test year data'—to comply with the statutory requirements regarding the test year, the utility may use estimated data in its application for an increase in rates. The utility *must* use at least three months actual

data for the operating income statements. * * * A utility *may* also file an income statement based on six months actual and six months estimated data. The utility must also explain any material differences between the estimated and actual data. * * *" (Emphasis added.)

On November 6, 1981, CBT filed its notice of intent to file an application for an increase in rates, and the commission approved its request for a test year of twelve months ending August 31, 1982. On March 1, 1982, CBT filed its application based on four months of actual data and eight months of estimated data. On April 30, 1982, the company filed a revised schedule of local service revenues based on six months of actual data and six months of estimated data. CBT's April filing contained estimates that its local service revenues during the test year would be approximately $2,243,000 less than originally estimated. Therefore, CBT made the April filing to secure an adjustment for the projected decrease. The commission, while revising two other aspects of CBT's revenues, refused to make the requested adjustment for a reduction in local service revenues. CBT maintains that the commission's refusal to effectuate the adjustment is unlawful and unreasonable.

CBT's primary contention is that pursuant to the Standard Filing Requirements the commission was obligated to make any and all revenue adjustments presented by the updated filing. The Standard Filing Requirements permit a public utility to file additional data with the commission for consideration in the rate case. However, nowhere do the requirements impose upon the commission a duty to adopt such data.

R.C. 4909.18 provides that at a hearing before the commission to determine a public utility's request for an

increase in rates, "* * * the burden of proof to show that the proposals in the applications are just and reasonable shall be on the public utility." Thus, CBT had the burden to demonstrate to the commission that an adjustment was justified based on its estimates of a reduction in local service revenues.

CBT failed to sustain its burden of proof when it offered no testimony before the commission on the issue of its requested budget adjustment. In fact, the only evidence on this issue completely supports the commission's decision not to implement the requested adjustment. For instance, staff witness Deborah A. Hensel stated that CBT's proposed adjustment affected only one facet of its operations and that "[t]he Applicant has not proposed adjusting any other operating revenue classifications or operating expenses for budget revisions or to reflect actual data." Continuing, Hensel stated that "[t]he Staff is of the opinion that it is not appropriate to adjust only one segment of the budget without adjusting other areas * * * [and that] the Staff believes that a change in revenues would have a corresponding impact on operating expenses. * * *"

The commission's rejection of CBT's budget adjustment is supported by the testimony presented at the hearing. Therefore, since the commission's decision on this aspect of CBT's application is not manifestly against the weight of the evidence or so clearly unsupported by the record as to show misapprehension, mistake or willful disregard of duty, it should be affirmed. *Cleveland Elec. Illum. Co. v. Pub. Util. Comm.* (1975), 42 Ohio St. 2d 403 [71 O.O. 2d 393], paragraph eight of the syllabus.

Case No. 83-733

In this appeal, OCC challenges the commission's opinion and order authorizing CBT to expense seventy-five percent of its station connection charges and to capitalize the balance of such charges.

This precise issue was recently presented in *Consumers' Counsel v. Pub. Util. Comm.* (1984), 10 Ohio St. 3d 49, wherein the commission allowed Ohio Bell to expense seventy-five percent of its station connection charges and to capitalize the remaining twenty-five percent of such charges during the precise test year which also exists in the case at bar. This court reversed the order of the commission and directed inclusion within the test year of only that portion of the station costs allowed under a prior commission directive.

Accordingly, we reverse the order of the commission *sub judice*.

Case No. 83-1595

As a result of this court's issuance of a stay of the commission's March 9, 1983 opinion and order, the commission, by entry dated April 6, 1983, ordered CBT to maintain proper accounts pursuant to R.C. 4903.18, showing the excess amount rates actually being charged as a result of the stay. A hearing was held on April 25, 1983. Thereafter the commission issued an order again changing CBT's ENFIA usage figure. CBT applied for a rehearing which was granted in part and denied in part. It is from the denial of CBT's application for rehearing that the instant appeal arises.

In the hearing conducted pursuant to R.C. 4903.18, the commission again changed CBT's ENFIA usage figure. As previously discussed, the appropriate usage level for ENFIA

was determined in the January 1983 opinion and order to be 3,402 minutes. In the commission's March 1983 entry on rehearing, the figure was changed to 4,474 minutes based upon a recent FCC order approving this level of ENFIA usage. On March 31, 1983, the FCC, upon reconsideration of its proceeding, revised ENFIA usage to 4,555 minutes, retroactively to May 1, 1982, which is well within CBT's test year.

In its first proposition of law, CBT challenges the commission's rejection of two exhibits as being hearsay. The exhibits, consisting of two letters written by FCC officials, were offered into evidence to clarify the FCC's position on ENFIA. CBT then embarks upon a lengthy argument contending that under Evid. R. 803 the documents were not inadmissible as hearsay.

In *Greater Cleveland Welfare Rights Org., Inc. v. Pub. Util. Comm.* (1982), 2 Ohio St. 3d 62, 68, this court addressed a similar contention as follows:

"We agree with appellants' contention that the commission is not stringently confined by the Rules of Evidence. The commission, however, is granted very broad discretion in the conduct of its hearings. *Elyria Telephone Co. v. Pub. Util. Comm.* (1953), 158 Ohio St. 441, 444 [49 O.O. 391]. Therefore, even if the commission did err in not overruling the hearing examiner's rulings striking portions of Stutz's testimony, it is well-settled that this court will not reverse an order of the commission because of an error * * * 'if such error did not prejudice the party seeking reversal.' *Cincinnati v. Pub. Util. Comm.* (1949), 151 Ohio St. 353 [39 O.O. 188], paragraph six of the syllabus. * * *"

The court concluded in viewing the totality of the evidence that appellants had not been prejudiced as a result of the commission's evidentiary rulings. Likewise,

in the present cause CBT failed to show it had been prejudiced when the commission adhered to an FCC ruling, the subject matter over which the parties concede the FCC has exclusive jurisdiction.

CBT next argues that the commission's increase of ENFIA usage from 3,402 minutes to 4,555 minutes unreasonably and unlawfully "unfreezes" its subscriber plant factor (SPF). SPF is a factor utilized by the commission to allocate a utility's investment in station equipment, subscriber lines and nontraffic sensitive portion of office equipment between interstate and intrastate jurisdiction. In February 1982, the FCC froze SPF factors at average 1981 levels as of April 1, 1982. CBT contends that as a result of the commission's decision to increase ENFIA usage from the 3,402 minutes to 4,555 minutes, its frozen SPF value has effectively been changed. A review of the record, however, reveals that the evidence before the commission does not support CBT's argument.

The evidence demonstrates that although SPF factors were frozen by the FCC, CBT has been incorrectly computing its SPF factor based upon 3,402 minutes, when its actual ENFIA usage totaled nearly 8,300 minutes. During this same period of time, American Telephone & Telegraph Company prepared a nationwide study revealing that average ENFIA holding times exceed 6,000 minutes.

In light of the evidence that CBT's actual ENFIA usage totaled nearly 8,300 minutes, and the FCC's recent ENFIA revisions, the commission concluded the CBT has been incorrectly computing its SPF based upon erroneous ENFIA calculations. Accordingly, the commission did not "unfreeze" CBT's SPF factor; instead, it merely adjusted it to accurately reflect the figure which should have been employed.

Finally, CBT seeks to raise objections to the commission's treatment of two accounts involving separation factors for accumulated deferred income taxes and depreciation. The record demonstrates that CBT's objections date back to August 30, 1982, the date on which the commission's staff released its report. Pursuant to R.C. 4909.19, any party having objections to the commission's staff report must file these objections within thirty days of its release. Although CBT did file objections to the staff report, it did not object to the treatment of separation factors applied to its accumulated deferred income tax and depreciation accounts. Again, in its application for rehearing of the commission's initial order released in January 1983, CBT did not voice any objections to the separation factors set forth in the staff report, or their treatment by the commission in its order.

R.C. 4903.10 provides in pertinent part:

"After any order has been made by the public utilities commission, any party who has entered an appearance in person or by counsel in the proceeding may apply for a rehearing in respect to any matters determined in said proceeding. Such application shall be filed within thirty days after the entry of the order upon the journal of the commission.

"* * *

"Such application shall be in writing and shall set forth specifically the ground or grounds on which the applicant considers said order to be unreasonable or unlawful. No party shall in any court urge or rely on any ground for reversal, vacation, or modification not so set forth in said application." (Emphasis added.)

It is well-established that "[t]he filing of an application for rehearing before the Public Utilities Com-

mission is a jurisdictional prerequisite to an error proceeding from the order of the Commission to this Court, and only such matters as are set forth in such application can be urged or relied upon in an error proceeding in this Court." *Travis v. Pub. Util. Comm.* (1931), 123 Ohio St. 355, paragraph six of the syllabus. See, also, *Communications Workers v. Pub. Util. Comm.* (1979), 57 Ohio St. 2d 76, 77 [11 O.O. 3d 244]. CBT, having failed to comply with either R.C. 4909.19 or 4903.10, may not now pursue an argument which procedurally should have been an issue in Case No. 83-392.

All aspects of the commission's opinions and orders in Case Nos. 83-392 and 83-1595 are reasonable and lawful, and the orders are therefore affirmed.

The order of the commission in 83-733 is unreasonable and unlawful and is therefore reversed.

The funds deposited in trust shall be distributed similar to the manner provided in *Columbus & Southern Ohio Elec. Co. v. Pub. Util. Comm.* (1984), 10 Ohio St. 3d 12, 16. The funds deposited pursuant to the stay granted on March 6, 1983, as subsequently modified, with interest collected thereon, shall be distributed to CBT's customers pursuant to R.C. 4903.19, upon approval by the court of the trustee's plan for distribution. The trustee is hereby authorized and directed to immediately take all steps necessary to prepare a plan for the distribution of the funds held pursuant to the stay order. The plan shall be submitted to the court for approval within forty-five days of this order and shall provide that distribution be made within ninety days of this order. CBT is ordered to cooperate with the trustee and provide all information the trustee deems necessary to effectuate compliance with this order.

Orders affirmed in case Nos. 83-392 and 83-1595.

Order reversed in case No. 83-733.

CELEBREZZE, *C.J.*, SWEENEY, C. BROWN and J.P. CELEBREZZE, *JJ.*, concur.

CELEBREZZE, *C.J.*, concurs separately.

LOCHER, *J.*, concurs in judgment only.

W. BROWN and HOLMES, *JJ.*, dissent.

CELEBREZZE, *C.J.*, concurring. I concur with the judgment and rationale of the majority opinion. I write separately, however, to emphasize that federal preemption of matters traditionally subject to state regulation will not be presumed in the absence of specific congressional intent.

If the federal judiciary decides that federal preemption of the power to fix depreciation rates for state ratemaking purposes is required as an incident to divestiture and is committed to enforcing it, so be it. However, such a radical change in policy is not, contrary to the implicit suggestion of the dissenters, to be presumed from the adoption of a regulation by the FCC. On the contrary, it is the view of a majority of this court that such a radical departure from the traditional interpretation of Sections 152(b)(1), 220(b), and 221(b), Title 47, U.S. Code requires specific congressional intent or at least a specific judicial declaration, binding upon this court, that such an interpretation is now mandated as the result of modern developments in the telecommunications industry.

For the same reasons, I cannot agree with the dissenters that a rehearing in this court or continuance of the stay will resolve the question. The salient facts will remain the same—prior to January 6, 1983, the Public Util-

ities Commission of Ohio prescribed depreciation rates for intrastate ratemaking purposes without objection from the federal sector; since that date, the FCC has issued a ruling that the identical statutes now require federal preemption, the validity of which has been upheld by the Fourth Circuit Court of Appeals upon its finding that it will facilitate divestiture.

The unanswered question is whether that FCC rule will be enforced against the states so as to preempt the states' power to fix depreciation allowances in telecommunications cases. This court is without jurisdiction to make that essential determination and, accordingly, the majority's decision is based upon the fact that the commission's order is in conformity with Ohio's ratemaking statutes.

Unlike the dissenters, I do not believe that CBT will be irreparably harmed by our decision today. If enforcement of the FCC order is sought, procedures are available to CBT to obtain a stay of execution pending any further litigation.

Neither the telecommunications industry nor the consumers are well-served by an ambiguous deregulation policy. Similarly, neither the states nor the federal government is well-served by an ambiguous preemption policy. Application of traditional preemption principles herein would leave the state's regulatory power intact. If policy requires federal preemption of state regulation of the telecommunications industry, Congress should make it explicit.

WILLIAM B. BROWN, J. dissenting. I disagree with the majority's position for two primary reasons. First, the majority has failed to acknowledge that the parties in this action, along with other state utility commissions and

public utility companies, were just recently involved in an action in the United States Court of Appeals, Fourth Circuit, wherein that court upheld the lawfulness of the FCC preemption order.[3] See Sections 2342 *et seq.*, Title 28, U.S. Code. Inasmuch as the federal circuit courts of appeals have exclusive jurisdiction in this area and, inasmuch as the resolution of that action has a direct and substantial impact on the outcome of this case, this court would be well-advised to set this cause for rehearing to allow the parties to rebrief and reargue orally the merits of this cause in light of the decision rendered by the federal court.

Secondly, the lifting of the stay and the concomitant release of the funds accumulated in this case at this time are unnecessary. Since March 9, 1983, the date when the commission ignored the FCC preemption order and proceeded to order CBT to instead utilize whole life depreciation accrual schedules, a stay has been in effect pursuant to this court's authority under R.C. 4903.16. By order of this court and in accordance with this stay, CBT has deposited over $13,000,000 into a trust account (see R.C. 4903.18), the vast majority of which represents the difference between depreciation rates prescribed by the commission and those ordered to be implemented by the FCC. This stay and the establishment of the trust account adequately protect both the public's interest in this case as well as CBT's. Nevertheless, the majority, in callous disregard of the decision released by the Fourth Circuit, has ordered the disbursement of this money to CBT's customers at this time. Since the FCC order was upheld by the Fourth Circuit, the release of this money at this point in time could irreparably harm CBT. Ac-

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3. Case No. 83-1136, argued October 7, 1983, released June 19, 1984

cordingly, in view of the fact that the stay currently in effect adequately protects both the interests of CBT and its customers, I would extend the stay pending rehearing of this cause before this court.

HOLMES, *J.*, dissenting. While I agree with Justice William Brown's opinion above, I write to voice my disagreement with other conclusions reached by the majority.

In case No. 83-392, the commission erred on rehearing when it considered additional evidence with respect to ENFIA usage and did not allow CBT to present rebutting evidence concerning the usage. This court has already held that such procedure is incorrect. In *Forest Hills Utility Co. v. Pub. Util. Comm.* (1974), 39 Ohio St. 2d 1 [68 O.O. 2d 1], the court examined a commission's ruling in which the commission took administrative notice of a utility's cost for the purpose of rate base considerations. The cost analysis was not available at the initial hearing and the utility was not given an opportunity to explain or rebut the figures. This court reversed the commission and stated that "'[e]ven though an administrative authority has statutory power to make independent investigations, it is improper for it to base a decision or findings upon facts so obtained, unless such evidence is introduced at a hearing or otherwise brought to the knowledge of the interested parties prior to decision, with an opportunity to explain or rebut.'" See, also, Annotation (1951), 18 A.L.R. 2d 552, and cases cited therein.

By failng to recognize *Forest Hills,* the majority establishes the precedent to allow the commission to take administrative notice of facts which are subject to dispute. Now the commission can effectively preclude a party from demonstrating the unworthiness of the evidence in ques-

tion. In my view, taking administrative notice of facts without permitting an opposing party the opportunity to explain or rebut such evidence is a denial of a fair hearing and due process.

As to the issue of expensing station connection charges within case No. 83-733, see my dissenting opinion in *Consumers' Counsel v. Pub. Util. Comm.* (1984), 10 Ohio St. 3d 49, 51.

In case No. 83-1595, the commission clearly abused its discretion when it ruled that two letters written by FCC members were inadmissible as hearsay. While the commission is not stringently confined to the Rules of Evidence in admitting evidence during an administrative proceeding, the rules do provide excellent criteria to guide the commission's discretion.

Evid. R. 803(8) sets forth the hearsay exception for public records and reports. In essence, a report is admissible under the rule if the official making the statement has a legal duty to report the matters contained in the document. The FCC officials who wrote the correspondence were duly authorized to engage in the activity, and the statements contained in the letters clarified the position of the FCC in matters relating to this appeal. Furthermore, one letter had an additional element of reliability as it was published in the Federal Register under the mandates of Section 552(a)(1)(D), Title 5, U.S. Code.

CBT has been prejudiced due to the commission's evidentiary rulings as it has not been afforded the opportunity to sufficiently address the subscriber plant factor issue. The FCC had already interpreted the factor. However, from the record it is apparent that the commission refused to consider this interpretation. CBT was thereby precluded from demonstrating the FCC's view that the freezing

of the subscriber plant factor permits corresponding fluctuation in the MTS/WATS or ENFIA factors to maintain an overall freeze. I believe the FCC interpretation was certainly relevant to this issue and the commission committed error in its refusal to consider such evidence.

Accordingly, I would extend the stay order pending a rehearing in case No. 83-392 to determine the lawfulness of the FCC preemption in light of the Fourth Circuit Court of Appeals' decision, and reverse the rulings made by the commission as to the foregoing issues.

ENTRY ON REHEARING OF THE PUBLIC UTILITIES COMMISSION OF OHIO

(Entered: March 9, 1983)

Case No. 81-1338-TP-AIR

BEFORE
THE PUBLIC UTILITIES COMMISSION
OF OHIO

In the Matter of the Application of Cincinnati Bell Inc. for Authority to Adjust Its Rates and Charges and to Change Its Tariffs.

ENTRY ON REHEARING

The Commission, coming now to consider the above-entitled matter, specifically the Opinion and Order issued on January 7, 1983, the applications for rehearing filed on February 7, 1983 by Cincinnati Bell Inc. and the Office of Consumers' Counsel, and the memoranda contra these applications filed on February 17, 1983 by Cincinnati Bell Inc., the Office of Consumers' Counsel, the American Alarm

Co., Inc., ADT Security Systems, Sonitrol of Cincinnati, Inc., the Greater Cincinnati Alarm Dealers Association, and the Ohio Cable Television Association, hereby issues the following Entry on Rehearing.

COMMISSION REVIEW AND DISCUSSION:

Pursuant to Section 4903.10, Revised Code, Cincinnati Bell Inc. (hereinafter Cincinnati Bell or the Company) has timely applied to the Commission for a rehearing with respect to certain matters decided in the January 7, 1983 Opinion and Order in this proceeding. The application alleges that the Opinion and Order is unreasonable or unlawful in the following particulars: the adoption of seven-day holding time studies for separations purposes, the disallowance of the budgeted local service revenues adjustment, the cost of equity calculation, the increase in terminal equipment rates, the percentage increase given recurring private line rates, the rejection of the Company's prospective resource cost studies for establishing nonrecurring rates, and the determination of pole attachment charges.

After considering Cincinnati Bell's application, the Commission is unpersuaded that rehearing should be granted on any of the particulars enumerated. We do feel compelled, however, to discuss our reasons for rejecting those arguments which were raised by the Company for the first time in its application for rehearing or which evidence a misunderstanding of the Opinion and Order in question.

As an alternative to allowing the continued use of five-day holding time studies for separations purposes, Cincinnati Bell now requests that the Commission increase the jurisdictional revenue requirement in order to afford the Company treatment "which is relatively comparable to the treatment afforded Ohio Bell" in Case Nos. 81-1433-TP-

AIR and 82-342-TP-ATA (December 22, 1982). This request is meritless. The fact that our adoption of seven-day studies decreased Cincinnati Bell's jurisdictional revenue requirement to a greater extent than Ohio Bell's was decreased in its most recent rate proceeding does not, in our opinion, constitute valid grounds for error. Such a comparison is irrelevant and abrogates the principle that every case must be decided based upon the evidence of record. In this proceeding, the record compiled fully supports the adoption of seven-day studies.

With regard to the cost of equity calculation, Cincinnati Bell maintains that the Commission committed error by adopting a growth rate which does not represent the five-year average "b x r" value and by selecting the point between the first and second quartiles of the Staff's recommended range as the cost of common equity. In support of its contention, the Company cites several rate cases wherein we utilized the five-year average "b x r" value and the midpoint of the range. We are not unmindful of the decisions cited. However, contrary to the implications of Cincinnati Bell's position on this issue, the determination of an appropriate cost of equity is not just a mechanical process whereby the application of a single approach will consistently produce reasonable results. The pertinent facts and circumstances contained in the record of each case require independent evaluation and necessitate an exercise of discretion in selecting the most reasonable measurement of the cost of equity for the subject utility company. To this end, we have not placed exclusive reliance on the five-year average "b x r" value for calculating the growth component nor blindly adhered to the midpoint of the Staff's recommended cost range, but have instead employed a variety of different analyses to achieve an appropriate result. The analysis we utilized in this

proceeding is fully discussed in the Order complained of and is, in our opinion, supported by the weight of the evidence.

Cincinnati Bell has advanced four arguments as justification for its opposition to the increased charges ordered for flexibly priced terminal equipment. Each of these contentions warrants only a cursory response. First, we do not agree that Section 4909.19, Revised Code, and *Cleveland Elec. Illum. Co. v. Public Util. Comm.*, 42 Ohio St.2d 403 (1975) preclude the Commission from considering the reasonableness of terminal equipment charges even though such charges were not put in issue by the Company. Since this issue involves rate design, the revenues derived from terminal equipment are directly related to rates which are the subject of the application. Furthermore, we would be derelict in our responsibility if we failed to examine terminal equipment charges and ensure that monopoly service customers are not subsidizing the competitive portion of the Company's operations. Second, we find that Cincinnati Bell's attack on the Staff's cost of service study is untimely. Section 4903.10, Revised Code, prohibits the taking of evidence on rehearing "which, with reasonable diligence, could have been offered upon the original hearing." We perceive no reason why the Company could not have expressed its disagreement with the terminal equipment aspect of the cost study during the course of the hearing in this proceeding. Third, the proposition that this Commission should have considered the substance of the *expected* outcome of the Company's *pending* Kentucky rate case is ludicrous on its face. Lastly, if Cincinnati Bell truly believes that increasing terminal equipment charges will detrimentally affect its competitive position, then it has the option of not implementing the increased prices and foregoing the associated revenues. Such

revenues are not properly assignable to non-terminal equipment categories.

Through its final assignment of error, Cincinnati Bell claims that the Commission arbitrarily ignored uncontroverted Company data in establishing pole attachment and conduit occupancy charges. We disagree and commend the testimony of Mr. Libertore, on behalf of the Ohio Cable Television Association, to the Company's attention (OCTVA Ex. 2, p. 4).

By application for rehearing filed on February 7, 1983, the Office of Consumers' Counsel (hereinafter Consumers' Counsel or OCC) alleges that the Opinion and Order issued in this proceeding is unreasonable or unlawful in seven respects, namely: the adoption of remaining life and equal life group (hereinafter ELG) depreciation accrual rates, the expensing of station connections at the 75 percent level, the recognition of the customer premises equipment phase-out, the authorization of separations factors which account for exchange network facilities for interstate access (hereinafter ENFIA) usage at the 3,402 minute level, the authorization of a curtailment adjustment, the failure to apportion any of the rate increase to optional measured rates, and the failure to require bill itemization. After considering this application, the Commission finds that the areas of station connections expensing, curtailment, and revenue distribution were adequately addressed in the Opinion and Order complained of and that no further discussion is warranted. Rehearing on these issues should, therefore, be denied. The remaining matters do require additional comment.

In its first assignment of error, OCC contests the Commission's rationale for adopting the vintage group remaining life depreciation accrual rates proposed by Cincinnati

Bell and authorized by the Federal Communications Commission (hereinafter the FCC). Upon review of this matter, we agree that our original holding was erroneous and that it should be reversed upon rehearing.

Pursuant to Section 4905.18, Revised Code, this Commission is vested with the duty to "ascertain, determine, and prescribe what are proper and adequate charges for depreciation . . ." and "may prescribe such changes in such charges for depreciation as it finds necessary." Moreover, in establishing rates for utility service, we must give due regard to the "necessity of making reservation out of the income for . . . depreciation. . . ." Section 4909.15(D)(1), Revised Code (*See also* Section 4909.05(H), Revised Code). In accordance with these statutory mandates, we have in prior cases rejected the remaining life methodology on the grounds that whole life depreciation rates strike a more equitable balance between the interests of the customers and the subject utility company (*See, e.g., Ohio Bell,* cited *supra,* at pp. 27-28). We have further held that the ELG methodology provides a better matching of plant retirements with capital recovery and have accordingly adopted the ELG accrual rates recommended by the Staff (*See, e.g., Ohio Bell,* cited *supra,* at pp. 28-29). As indicated in the Opinion and Order at issue, we would have followed such precedent in this proceeding but for the two cited FCC decisions. We are now of the opinion that this logic is not legally supportable. Neither the FCC nor the Commission is empowered with the authority to rule on the question of federal preemption; that responsibility lies with a court of competent jurisdiction. Therefore, until such time as an applicable judicial decision is rendered, we will, consistent with our statutory mandate, continue to approve the depreciation accrual rates which we believe are the most reasonable.

In this proceeding, the most reasonable depreciation accrual rates were proposed by the Staff based upon the whole life and ELG methodologies. We will, therefore, grant the rehearing OCC requests and direct Cincinnati Bell to file revised tariffs, along with worksheets supporting its calculation, within seven days of the journalization date of this Entry. These revised tariffs should effectuate the adoption of the Staff's recommended whole life and ELG depreciation accrual rates, on an annualized basis, and should result in a rate reduction which maintains the existing proportionality of revenue responsibility. We expressly reserve ruling on whether an evidentiary hearing on this matter is warranted until we have had an opportunity to review Cincinnati Bell's calculations.

OCC's third assignment of error is directed at the Commission's interpretation of the May 28, 1982 FCC authorized amendment to the *Separations Manual* with respect to the phase-out of customer premises equipment. According to Consumers' Counsel, the amendment did not grant state commissions the discretion to implement the phase-out prior to January 1, 1983, as we stated in the Opinion and Order, but rather, authorized the establishment of a freeze date prior to December 31, 1982, after which no changes in the amount of investment in customer premises equipment could be made for separations purposes. The specific language of the amendment reads as follows:

> If so directed or authorized by an administratively and judicially final order or action issued or taken by the State Commission having jurisdiction in any states, a *freeze date* earlier than December 31, 1982 may be adopted for any company operating within the state with the concurrence of such company. The amount of investment recorded for separations pur-

poses as of that *freeze date* shall be deemed to be the amount of investment to be used for separations until January 1, 1983. Thereafter, the provision of this Manual addendum shall apply as set forth hereafter. Expenses, taxes and reserves shall be frozen as of the plant freeze date in a manner consistent with the addendum (Emphasis added).

Since the issuance of the Opinion and Order in this proceeding, we have re-examined the FCC's amendment and concluded that our understanding thereof was incorrect (*Ohio Bell,* cited *supra,* [Entry on Rehearing, February 16, 1983] at p. 4). We now agree with OCC that the amendment authorized the adoption of an earlier freeze date, not an earlier implementation of the phase-out. As a result, we will grant the rehearing Consumers' Counsel requests and find that the Company proposed phase-out of customer premises equipment is a post-test year adjustment which should be denied. Cincinnati Bell should, therefore, file revised tariffs, and supporting workpapers, within seven days of the journalization date of this Entry to remove the first year effect of the phase-out. Because this adjustment has a relatively minor impact on the rate increase granted, the Company should apply the revenue reduction to the rates of its basic exchange subscribers.

Through its fourth assignment of error, OCC seeks rehearing of the Commission's determination that the separations factors should account for ENFIA usage at the 3,402 minute level. A minimum of 4,474 minutes should instead be utilized, according to OCC, because the September 29, 1982 FCC Order adopted that level of ENFIA usage retroactive to May 1, 1982.

After reconsidering this matter, we believe that the latest FCC approved level of usage for ENFIA is the most appropriate figure to use for separations purposes (*See*

Ohio Bell, cited *supra*, at p. 10). We will, therefore, grant the rehearing requested by OCC and take administrative notice of the cited FCC decision. Cincinnati Bell should accordingly prepare and file revised tariffs, along with worksheets supporting its calculation, which reflect separations factors based on ENFIA usage at the 4,474 minute level within seven days of the date of this Entry. Again, because this change has a relatively minor impact on the rate increase granted, the revenue reduction should accrue to basic exchange subscribers.

Lastly, OCC opposes our decision not to require Cincinnati Bell to itemize its customers' bills so that customers are able to readily determine the precise amount charged for each individual service. In the Opinion and Order at issue, we required the Company to include in its rate increase notices information indicating: (1) that Company provided telephone sets are leased by the customer; (2) that the charge for such equipment is included on the monthly service and equipment line of the customer's telephone bill; and (3) the Company's current charges for such equipment. We realize that these provisions are only a small step from the bill itemization requested by OCC. Upon review of the record, we find that the bill itemization would better serve the interests of Cincinnati Bell's subscribers. Therefore, the Company is directed to begin itemizing its customers' bills so that the customers know how much they are paying each month for Company provided terminal equipment. For business customers, itemization shall consist, at a minimum, of a separate listing of the total charges for all terminal equipment. For residential customers, itemization shall be provided, at a minimum, on a per type of equipment basis, showing the number of sets provided (e.g., two standard Touch-Tone telephones, one Princess Touch-Tone tele-

phone) and the total charges for each type of equipment provided. The Company is directed to begin itemization of customer bills with the earliest practicable billing cycle.

As a result of the foregoing changes, the Company's authorized increase will be less than the $22,500,000 approved in the January 7, 1983 Opinion and Order in this case. Cincinnati Bell is ordered to compute a revised authorized increase amount consistent with the directives set forth above and to apply the revenue difference to reduce the rates of the customer classes specified. Worksheets supporting its calculation of the revised authorized increase amount should be submitted by the Company with the revised tariffs.

ORDER:

It is, therefore,

ORDERED, That the Opinion and Order dated January 7, 1983 in this docket be modified to the extent provided above. It is further,

ORDERED, That the application for rehearing filed by Cincinnati Bell on February 7, 1983 be denied. It is, further,

ORDERED, That the application for rehearing filed by Consumers' Counsel on February 7, 1983 be denied in part and granted in part as provided herein. It is, further,

ORDERED, That Cincinnati Bell file within seven days of the date this Entry is journalized revised tariffs, for approval by subsequent Commission Entry, reflecting the changes directed herein. It is, further,

ORDERED, That the January 7, 1983 Opinion and Order in this proceeding be affirmed in all other respects. It is, further,

ORDERED, That a copy of this Entry on Rehearing be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION
OF OHIO

/s/ MICHAEL DEL BANE
(Chairman)

/s/ WILLIAM BROOKS
(Commissioners)

Entered in the Journal
MAR 9 1983

A True Copy

/s/ MARY ANN ORLINSKI
Mary Ann Orlinski
Secretary

OPINION AND ORDER OF THE PUBLIC UTILITIES COMMISSION OF OHIO

(Entered: January 7, 1983)

Case No. 81-1338-TP-AIR

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Cincinnati Bell Inc. for Authority to Adjust its Rates and Charges and to Change its Tariffs.

OPINION AND ORDER

The Commission, coming now to consider the above-entitled application filed pursuant to Section 4909.18, Revised Code, the exhibits filed therewith, the Staff Report of Investigation issued pursuant to Section 4909.19, Revised Code, the testimony and exhibits introduced into evidence at the public hearings, and the post-hearing briefs and late-filed exhibits submitted by the parties; having appointed its attorney examiners Kenneth W. Christman and Beth Ann Burns, pursuant to Section 4901.18, Revised Code, to conduct the public hearings in this case and to certify the record directly to the Commission; and being otherwise fully advised of the facts and issues in this case, hereby issues its Opinion and Order.

APPEARANCES:

Frost & Jacobs, by Mr. Earl R. Huffman and Mr. Mark H. Longenecker, Jr., 2500 Central Trust Center, 201 East Fifth Street, Cincinnati, Ohio 45202, and Mr. James M. Honaker, Sower Building, Frankfort, Kentucky 40601, on behalf of Cincinnati Bell Inc

Mr. William J. Brown, Attorney General of Ohio, by Ms. Jane L. Miller and Mr. Jonathan L. Heller, Assistant Attorneys General, 375 South High Street, Columbus, Ohio 43215, on behalf of the Staff of the Public Utilities Commission.

Mr. William A. Spratley, Consumers' Counsel, by Mr. John Parks Hopkins, Ms. Janine Migden, Mr. Michael A. Byers, and Mr. Bruce Weston, Associate Consumers' Counsel, 137 East State Street, Columbus, Ohio 43215, on behalf of the residential consumers of Cincinnati Bell Inc.

Mr. Richard A. Castellini, City Solicitor, and Mr. W. Peter Heile, Assistant City Solicitor, City Hall, Room 214, Cincinnati, Ohio 45202, on behalf of the City of Cincinnati.

Bell & Randazzo Co., L.P.A., by Mr. Langdon D. Bell, Mr. Samuel C. Randazzo, Mr. John W. Bentine, and Ms. Judith B. Sanders, 21 East State Street, Columbus, Ohio 43215, on behalf of the Tri-State Telecommunications Association (hereinafter TSTA).

Watkins, McGugin, McNeilly & Rowan, by Mr. Daniel R. Loftus, 18th Floor, First American Center, Nashville, Tennessee 37238, and Bricker & Eckler, by Ms. Sally W. Bloomfield and Mr. David V. Stivison, 100 East Broad Street, Columbus, Ohio 43215, on behalf of the American Alarm Company, Inc., ADT Security Systems, Sonitrol of Cincinnati, Inc., and the Greater Cincinnati Alarm Dealers Association (hereinafter the Alarm Intervenors).

Bricker & Eckler, by Ms. Sally W. Bloomfield, Mr. David V. Stivison, and Ms. Andromeda Monroe, 100 East Broad Street, Columbus, Ohio 43215, on behalf of the Ohio Independent Communications Association hereinafter OICA) and Answering Exchange, Inc. (hereinafter Answering Exchange).

Vorys, Sater, Seymour & Pease, by Mr. William S. Newcomb, Jr., 52 East Gay Street, P.O. Box 1008, Columbus, Ohio 43216, and Hogan & Hartson, by Mr. Gardner F. Gillespie and Mr. Paul Glist, 815 Connecticut Avenue, Washington, D.C. 20006, on behalf of the Ohio Cable Television Association (hereinafter OCTVA).

Condo, Walsh, Schiavone, Spillane & Miller, by Ms. Leslie Spillane, 508 Rentschler Building, Hamilton, Ohio 54011, on behalf of the Hamilton Telephone Answering Service, Inc. (hereinafter Hamilton Answering).

HISTORY OF THE PROCEEDINGS:

Cincinnati Bell Inc. (hereinafter Cincinnati Bell, the Company, or the Applicant) is an Ohio corporation associated with the Bell System. Its largest shareholder, American Telephone & Telegraph (hereinafter AT&T) owns approximately 31.2 percent of the outstanding common stock shares. Cincinnati Bell is engaged in the business of furnishing communications services in four counties in southwestern Ohio, six counties in northern Kentucky, and two counties in southeastern Indiana. The Applicant is a telephone company and a public utility within the definitions set forth in Sections 4905.02 and 4905.03(A)(2), Revised Code, and as such, is subject to the jurisdiction of this Commission pursuant to Sections 4905.04, 4905.05, and 4905.06, Revised Code.

On November 6, 1981, Cincinnati Bell filed a notice with this Commission of its intent to file an application for an increase in rates charged to Ohio customers. By Entry dated November 25, 1981, the Commission approved the requested test year consisting of the 12 months ended August 31, 1982, with a date certain of February 28, 1982. On January 28, 1982, Cincinnati Bell submitted a request

for a waiver exempting the Company from filing certain schedules with its application. This request was granted in part by the Commission's February 24, 1982 Entry. On March 1, 1982, Cincinnati Bell filed its application, which was accepted for filing as of that date by Entry issued on March 31, 1982. The Company filed updated or revised schedules on May 30, 1982, July 16, 1982, and September 20, 1982.

Subsequent to the filing of Cincinnati Bell's application, several parties petitioned the Commission for leave to intervene in this proceeding. By Entries dated March 22, 1982, March 30, 1982, April 28, 1982, July 19, 1982, and August 23, 1982, leave to intervene was granted to the Office of Consumers' Counsel (hereinafter OCC), the City of Cincinnati (hereinafter the City), TSTA, the Alarm Intervenors, OICA, Answering Exchange, OCTVA, and Hamilton Answering.

In accordance with the provisions of Section 4909.19, Revised Code, the Commission Staff conducted an investigation into the matters set forth in the application and attendant exhibits. A written report of the investigation's results was filed on August 30, 1982 and was served pursuant to Section 4909.19, Revised Code. On September 16, 1982, revisions to pages 38-40, 66, and 67 of the Staff Report were docketed. Objections to the Staff Report were timely filed by Cincinnati Bell, OCC, the City, TSTA, the Alarm Intervenors, OICA, Answering Exchange, and OCTVA.

Several of the respective objections entered by OICA and Answering Exchange relate to the September 16, 1982 revisions of the Staff Report. In the opinion of these two parties, the submission and use of revised data which constitutes a material alteration of the analysis presented

in the Staff Report precludes the opportunity to conduct discovery thereon, impedes case preparation, and is improper. OICA and Answering Exchange further object to using the date on which the Staff Report was originally filed, rather than the date on which the revisions were filed, for purposes of calculating periods of limitation.

While the Commission recognizes that amendments to the Staff Report may interject an element of inconvenience and uncertainty into the parties' case preparations, we are not persuaded that the revisions in question were improperly issued. In the absence of evidence establishing the existence of prejudice, the Commission's interest in obtaining the most accurate data available must prevail. Here, since neither OICA nor Answering Exchange has established or even claimed that it was prejudiced by the revisions, the objections should be overruled.

By Entry dated September 9, 1982, the Commission scheduled the public hearing in this matter to commence on October 14, 1982 in Cincinnati, Ohio for the purpose of taking statements from interested members of the public. Notice of the application and hearing was published in accordance with Section 4909.19, Revised Code. The hearing commenced as scheduled and was then continued on October 20, 1982 at the offices of the Commission in Columbus, Ohio. After 17 days of testimony the hearing concluded on November 16, 1982. Post-hearing briefs were submitted on November 23, 1982 and December 1 and 7, 1982. Any objections not discussed in the briefs are deemed to have been withdrawn.

COMMISSION REVIEW AND DISCUSSION:

This case comes before the Commission upon the application of Cincinnati Bell Inc., pursuant to Section 4909.18, Revised Code, for authority to increase its rates and charges for customers located in Ohio. If the rates proposed by the Applicant had been in effect during the test period, additional operating revenues of approximately $42,684,000 would have been generated (Staff Ex. 1, p. 1). The task now confronting the Commission is to evaluate the evidence presented at the public hearing and to determine whether Cincinnati Bell's existing rates are inadequate. If the Applicant sustains its burden of proof on this issue, the Commission must then establish rates which will afford the Company an opportunity to earn a fair rate of return.

SEPARATIONS

Cincinnati Bell provides telephone service in portions of Ohio, Kentucky, and, to a very minor degree, Indiana. Consequently, there is multiple responsibility for the regulation of the Applicant's property since the interstate services are subject to the jurisdiction of the Federal Communications Commission (hereinafter the FCC), while the intrastate services are under the jurisdiction of the Ohio, Kentucky, and Indiana utility commissions. Given this multiplicity of regulatory responsibility, the Applicant's telephone property, revenues, and expenses should be separated between the various intrastate and interstate services in order to ensure that the rate of return authorized herein is applied only to property rendering service to customers affected by the instant application. The Indiana operation, with a small number of telephones, has no significant influence on the allocation (separations) procedures and was included with

Ohio for purposes of this proceeding, as it has been in prior cases. A uniform method of separations is prescribed by the *Separations Manual,* which is prepared by the NARUC-FCC Cooperative Committee on Communications (Staff Ex. 1, pp. 3-4).

The Staff has examined the separations procedures employed by Cincinnati Bell to assure compliance with the *Separations Manual.* As a result of this examination, it was determined that the Applicant's separation procedures are generally in accord with the *Manual* and that they provide a reliable source of allocation data (*Id.,* at 5). The Staff did, however, recommend that an adjustment be made to the Company's proposed jurisdictional allocation factors for interstate foreign exchange (hereinafter FX) service. OCC concurs with the adjustment recommended by the Staff and additionally proposes adjustments to the separation of common control switching arrangements (hereinafter CCSA), the minutes of usage for exchange network facilities for interstate access (hereinafter ENFIA), the subscriber plant factor (hereinafter SPF), and the usage based on five day, rather than seven day, studies. Each of these recommendations will be discussed individually below.

Interstate Foreign Exchange Service

Interstate FX service is a combination of private line and exchange equipment which enables Ohio customers of Cincinnati Bell to place calls to, and receive calls from, telephones located outside of the state without paying toll charges (Staff Ex. 1, p. 5). The private line portion of this service has been directly assigned to the Applicant's interstate operations and, therefore, is not at issue (*Ibid.*). Instead, the controversy relates to the customers' common equipment, such as a PBX terminal, lo-

cated within the Applicant's Ohio service territory; that is, whether the usage of such common facilities to place a call across state lines should be allocated to the interstate or intrastate jurisdiction (*Ibid.*). Company witness Collard supports the Applicant's proposed treatment of this usage as intrastate, whereas Staff witness Fox and OCC witness Montanye characterize the service as interstate and recommend an adjustment to allocate it accordingly (*see generally* Co. Ex. 6A; Staff Ex. 11, pp. 24-29; OCC Ex. 5, pp. 20-21).

The specifics of the testimony presented by these witnesses and the arguments raised by their respective sponsoring parties need not detain us. This Commission has addressed the separation of interstate FX service in a number of prior cases (*Ohio Bell Tele. Co.*, Case No. 79-1184-TP-AIR [December 3, 1980] at p. 7 and [March 18, 1981] at p. 2; *Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR [July 15, 1981] at p. 5; *Ohio Bell Tele. Co.*, Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM [April 21, 1982] at pp. 4-5) and considered the matter at length more recently in *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 5-7. In each of these Opinion and Orders, we found that interstate FX service should be allocated to the interstate jurisdiction and adopted the Staff's recommendation effectuating that result. We perceive nothing novel in the record of the instant proceeding which persuades us to depart from this precedent. Therefore, for the reasons articulated in the above-cited cases, and especially those set forth in the recent *Ohio Bell Tele. Co.* decision, we will authorize the use of separation factors which incorporate the treatment of interstate FX service as recommended herein by the Staff and OCC.

Common Control Switching Arrangements

CCSA is a closed network private line switching system usually configured for an individual customer, such as a business with multi-state offices, whereby the customer is able to call other locations on the network without paying toll charges (Tr. IV, pp. 53-55; Tr. XII, p. 156). A CCSA customer may also avoid the incurrence of toll charges by adding off-network local access lines to the arrangement (Tr. IV, pp. 54-55; Tr. XIII, pp. 140-141). This latter feature of CCSA is similar to interstate FX service, but is not offered by the Company for the purpose of affording open ended interstate usage (Tr. IV, p. 54; Staff Ex. 11, p. 21).

OCC witness Montanye has proposed that the interstate portion of the CCSA off-network usage be allocated to the Applicant's interstate operations (Tr. XII, pp. 158-169; *See generally* OCC Ex. 55, pp. 20-24). While Staff witness Fox indicated an agreement in principle with such an allocation, he declined to recommend any adjustment for CCSA in this proceeding on the grounds that the open ended interstate usage is neither offered nor controlled by Cincinnati Bell, that the data necessary for the allocation is unavailable, and that the anticipated filing of access charge tariffs in the near future will render the issue moot (Staff Ex. 11, p. 21; Tr. XIII, pp. 140-141, 146-147). The Applicant also opposes the adjustment.

OCC has recommended an allocation of interstate CCSA off-network usage on two prior occasions, and in both of those cases this Commission found that although the usage in question appeared to be comparable to interstate FX service, the allocation was not required since the FCC has treated CCSA and interstate FX differently for separations purposes (*Ohio Bell Tele. Co.*, Case Nos. 81-436-TP-

AIR and 80-1010-TP-AAM [April 21, 1982] at pp. 5-6; *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 7-8). In accordance with this precedent, and for the reasons enumerated by Mr. Fox, we will again deny the adjustment OCC proposes. In reaching this conclusion, we are not unmindful of Mr. Fox's belief that some interstate allocation of CCSA usage may possibly be appropriate nor of his statement that if access charge tariffs are not filed, some measurement of CCSA usage may be needed (*See* Tr. XIII, pp. 140-141, 145). The tentative nature of this testimony and the lack of actual data have simply not persuaded us that a departure from precedent is currently warranted. We may, however, be willing to reconsider this issue in the future if the referenced tariffs are not ultimately filed. To this end, Cincinnati Bell should submit representative data on interstate CCSA off-network usage at its next rate proceeding unless such usage has by then become subject to access charges.

Holding Time Studies

Cincinnati Bell presently relies upon seven day holding time studies to develop the subscriber line usage (hereinafter SLU) factor used for allocating category 3 central office equipment, but utilizes five day holding time studies for separating the remainder of its joint exchange costs (OCC Ex. 5, p. 13). According to OCC witness Montanye, the five day studies are not representative of network usage and their use is, therefore, not in conformance with Paragraphs 11.212 and 23.444(a) of the *Separations Manual* (*Id.*, at 12). [Paragraph 11.212 requires that in the development of "actual use" measurements, measurements of use are to be determined "for telephone plant or for work performed by operating forces on a unit basis . . . in studies of traffic

handled or work performed during a representative period . . ." (Co. Ex. 6, Part 1). Paragraph 23.444(a) requires that the average SLU for calendar year 1981 be measured by "the ratio of interstate holding time minutes of use to total holding time minutes of use applicable to traffic originating and terminating in the study area. . ." (*Ibid.*)]. Mr. Montanye further testified that Cincinnati Bell's failure to measure usage on a representative basis has caused the state revenue requirement to be overstated by a substantial amount (OCC Ex. 5, p. 12). To cure these perceived defects, this witness recommends that the separation factors adopted herein be based upon seven day holding time studies (*Id.*, at 15). In accordance with his recommendation, Mr. Montanye has provided separation factors derived from seven day studies performed by the Applicant for 10 of its 42 central offices (*Id.*, at 13-14).

Cincinnati Bell and the Staff oppose the implementation of seven day holding time in this proceeding for primarily two reasons. First, as noted by Staff witness Fox, the use of seven day studies for separations purposes is an issue pending before a Federal-State Joint Board which is expected to reach a decision in early 1983 (Staff Ex. 11, p. 22). Secondly, five day holding period data has been widely utilized by the telephone industry for over a decade (*Ibid.*).

OCC's recommendation and the arguments raised in opposition to that proposal are nearly identical to those presented in *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-AIR (December 22, 1982) at pp. 8-9, wherein we adopted separations factors based upon seven day holding time studies. We perceive no reason to reach a different result herein. While we acknowledge that five day studies may have been the norm when the present *Separations Manual* was promulgated, the *Manual* does not

specify the length of the studies to be utilized, but does require that usage studies be developed using representative periods. It is our opinion that the Applicant's five day studies are not based upon representative periods and that they are biased to the detriment of jurisdictional customers. Furthermore, we remain unpersuaded that the pending Joint Board decision should restrain us from taking immediate remedial action. Lastly, there is no record evidence that the seven day studies performed by the Company and accepted by Mr. Montanye are unrepresentative (*See* Tr. IV, pp. 68-69). For these reasons, OCC's recommendation should be adopted. Cincinnati Bell should henceforth base its separations factors on seven day holding time studies.

Exchange Network Facilities for Interstate Access

ENFIA usage is that portion of interstate usage associated with specialized common carriers, such as MCI, who use Cincinnati Bell's exchange facilities to originate and terminate message toll-like calls (OCC Ex. 5, p. 26). The provision of ENFIA services is within the FCC's jurisdiction, is governed by a local interconnections agreement negotiated by AT&T and the other common carriers, and is presently regarded as interstate for separations purposes (*Ibid.*; Tr. IV, pp. 58-59). Under the negotiated agreement, the other common carriers are obligated to reimburse the Bell System Operating Companies for the use of their exchange facilities at a usage of 3,402 holding time minutes of average use per month. The Applicant's separation factors account for ENFIA usage at this level (Tr. IV, p. 57).

In the opinion of OCC witness Montanye, the allocation proposed by Cincinnati Bell ascribes only a fraction of assignable ENFIA costs to the interstate jurisdiction (OCC

Ex. 5, p. 27). This belief is grounded on traffic studies which were conducted by the Company in August 1981 and which show the actual holding time minutes of use per ENFIA line to be 8300 (*Ibid.*). Mr. Montanye suggests that this figure, rather than 3,402 minutes, should be utilized to allocate ENFIA usage (OCC Ex. 5, p. 28). Both the Company and the Staff disagree with the OCC recommendation (*See, e.g.*, Staff Ex. 11, pp. 22-23).

After reviewing the record evidence pertinent to this issue, it is the Commission's conclusion that the adjustment OCC proposes is simply too speculative to warrant adoption. As explained by Staff witness Fox, the 8300 minutes of use was derived from traffic studies conducted for only one month, and there is no assurance that the month selected for study is representative of ENFIA usage throughout the test year (Tr. XIII, p. 148). We will accordingly authorize the use of Cincinnati Bell's separation factors which account for ENFIA usage at the 3,402 minute level.

Subscriber Plant Factor

SPF is one of the factors utilized by the telephone industry to allocate operations between the interstate and intrastate jurisdictions (Tr. IV, pp. 36-37). By Order dated February 26, 1982 in Docket No. 80-826, the FCC required that the interstate SPF value be frozen at the average value for calendar year 1981 (*See* Co. Ex. 25). For separations purposes in this proceeding, however, Cincinnati Bell developed its SPF based upon the results of a study encompassing the twelve month period ended September 30, 1981 (Tr. IV, p. 60; OCC Ex. 5, p. 25). The effect of using this SPF, rather than the frozen 1981 value, is an overstatement of the jurisdictional allocation factors, according

to Mr. Montanye (OCC Ex. 5, p. 25). Both OCC and the Staff recommend that the allocation factors presented by the Applicant be adjusted to reflect the average 1981 SPF value as frozen by the FCC. Cincinnati Bell opposes the recommendation on the grounds that adoption of the frozen SPF would not significantly alter the separation factors it proposed.

The Commission perceives no merit in the Company's argument. While we recognize that the average 1981 SPF is only approximately 2.5 percent greater than the SPF value developed by the Applicant (*Ibid.*), we nevertheless believe that the frozen SPF is a more appropriate basis for calculating the allocation factors. OCC's recommendation, as joined in by the Staff, should therefore be adopted.

RATE BASE

The Applicant, the Staff, and Consumers' Counsel offered testimony in support of their respective rate base proposals in this proceeding. The following table compares the three initial estimates of the value of Cincinnati Bell's property used and useful in rendering service to customers affected by the instant application as of the date certain, February 28, 1982. Subsequent adjustments and relevant objections will be discussed on an item-by-item basis below.

Jurisdictional Rate Base

(000's Omitted)

	Applicant[1]	Staff[2]	OCC[3]
Plant In Service	$621,202	$605,530	$560,133
Less:			
Depreciation Reserve	133,634	118,953	114,394
Net Plant In Service	$487,568	$486,577	$445,739
CWIP	1,280	1,277	1,163
Working Capital	5,882	4,362	2,923
Less:			
Deferred Taxes and Other Deductions	71,775	78,220	75,763
Jurisdictional Rate Base	$422,955	$413,996	$374,062

Plant in Service

Expensing Station Connections

By Order dated March 31, 1981 in Docket No. 79-105, the FCC amended Part 31 of the Uniform System of Accounts for Class A and Class B Telephone Companies. Pursuant to this Order, Account 232, Station Connections, is to be divided into two subclasses: Station Connections—Inside Wiring, and Station Connections—Other (outside drop wire and protector), with new additions of inside wire to be expensed rather than capitalized and with the embedded investment in inside wiring to be amortized over

1. Co. Ex. 14, Sched. B-1
2. Staff Ex. 1, Sched. 7
3. OCC Ex. 2, Sched. 2

a ten year period. The Order further provided that the implementation of these accounting changes could be accomplished on a flash-cut or four year phase-in basis (OCC Ex. 3, pp. 3-4). On July 31, 1981, this Commission issued an Entry in Case No. 81-828-TP-ORD which extended the treatment provided in the FCC Order to telephone companies subject to our jurisdiction and which required the phase-in approach. In accordance with the FCC Order, this phase-in is to become effective at the 25 percent level on January 1, 1981, the 50 percent level on January 1, 1982, the 75 percent level on January 1, 1983, and the 100 percent level after January 1, 1984 (Tr. XIII, p. 161).

Cincinnati Bell proposed an adjustment to its date certain rate base and test year operating income to reflect the 75 percent level of expensing station connections additions (Staff Ex. 1, pp. 17-18). The Staff has reviewed the Applicant's adjustment and has determined that it is proper, as well as consistent with the FCC Order in Docket No. 79-105 and the Commission Entry in Case No. 81-828-TP-ORD, discussed above (*Id.*, at 18). The Staff's rationale, briefly stated, is that the 75 percent level of expensing station connections is a known and measurable cost change, similar to a change in tax rates, which will be in effect during the time rates ordered as a result of this proceeding are effective (Staff Ex. 11, p. 13).

While OCC witness Corneille does not dispute the necessity of an adjustment, he recommends that the adjustment be limited to expensing station connection additions at the 50 percent level reflected on the Company's books at date certain (OCC Ex. 3, p. 4). Since the higher expensing rate does not become effective until January 1, 1983, four months after the end of the test year, OCC maintains that adoption of the Company and Staff posi-

tion would constitute a post-test year adjustment in contravention of *Consumers' Counsel v. Public Util. Comm.*, 67 Ohio State 2d 372 (1981).

This identical issue was recently addressed by the Commission in *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-AIR (December 22, 1982) at pp. 40-42, wherein we rejected OCC's arguments and approved an adjustment reflecting the 75 percent level phase-in. There is no evidence in the instant record which convinces us that this decision is either incorrect or inapplicable herein. Therefore, based upon our precedent and the testimony presented by Staff witness Fox (Staff Ex. 11, pp. 13-15), we will overrule OCC's objection. The adjustment to date certain rate base and test year operating income, as calculated by the Staff, should accordingly be adopted.

Land Exclusions

After conducting a selective sampling of the land parcels owned by Cincinnati Bell in the Applicant's last rate proceeding, Case No. 80-476-TP-AIR, the Staff found that certain portions of four parcels were not used and useful at the then date certain and recommended that the portions be excluded from plant in service (Staff Ex. 1, p. 14). Although the recommendation was accepted by the Commission without Company objection, the Staff Report issued in this proceeding states that the real estate in question presently remains fully valued as plant in service (*Ibid.*). A $106,993 adjustment to exclude the non-used and useful portions of the four parcels has, therefore, again been proposed by the Staff (Staff Ex. 1, p. 15; Staff Ex. 11, p. 32).

Through its filed objections, Cincinnati Bell objected to the Staff's adjustment. The statement contained in the Staff Report, according to the Applicant, is based upon a

Company response to discovery which erroneously failed to recognize that the land had been reclassified from Account 100.1, Telephone Plant In Service, to Account 103, Miscellaneous Physical Property, on the corporate books and continuing property records as of June 1981. Rather than easily substantiating its claim through supplemental or rebuttal testimony, however, Cincinnati Bell pursued this matter during cross-examination of Staff witness Fox by showing him a journal entry and a Form Mannual report to the FCC which purported to indicate that the exclusions had already been accomplished (Tr. XIII, pp. 72-76, 78-80). After reviewing these documents, Mr. Fox expressed his personal belief that the real estate had been excluded by the Applicant, but indicated dissatisfaction with the adequacy of the documentation because the amounts shown to be reclassified were not specifically identified as relating to the land parcels (*Id.*, at 75-76).

While the Commission finds the record on this issue somewhat indirect, we are nevertheless satisfied that Cincinnati Bell excluded the land in question from its proposed plant in service valuation. The journal entry admitted into evidence as Co. Ex. 26 does reclassify four land parcels to Account 103, Miscellaneous Physical Property, in an aggregate amount nearly identical to the exclusion recommended by the Staff. Cincinnati Bell's objection should, therefore, be sustained.

Art Works

The plant in service valuation submitted by Cincinnati Bell includes $321,958, on a total company basis, for 486 works of new art purchased from over 300 local or locally connected artists (Staff Ex. 1, p. 15). All 486 works are currently on display in non-public areas of the Applicant's office building (*Ibid.*). As the sole support for including the art in rate base, Cincinnati Bell on brief claims that

it is an integral part of the total investment in furniture and office equipment designed to provide office space that is functionally and esthetically conducive to efficient work.

Staff witness Fox recommends that the $321,958 be excluded from plant in service on the grounds that art lacks the functional nature of Account 261 items such as furniture and office equipment, that purchasing only locally produced art is a form of charitable contribution to the community, and that displaying the works in non-public areas of the corporate offices constitutes a form of employee fringe benefit not generally recognized for regulatory purposes (Staff Ex. 1, pp. 15-16; Staff Ex. 11, p. 33). OCC concurs with the Staff's recommendation (OCC Ex. 2, p. 10) and so do we. For reasons adequately discussed by Mr. Fox, the Commission finds that the art work does not fulfill the used and useful standard which is set forth in Section 4909.15(A), Revised Code, and which governs the inclusion of property in rate base. The Applicant's objection is hereby overruled and the Staff's adjustment adopted.

Customer Premises Equipment Phase-Out

By Order dated April 2, 1982 in Docket No. 80-286, the FCC adopted a Federal-State Joint Board proposal for the gradual removal of customer premises equipment (hereinafter CPE) from the separations process (Tr. XII, p. 119; OCC Ex. 5, p. 29). Under the terms of the Order, the investment in CPE is to be shifted from the interstate jurisdiction to the intrastate jurisdiction over a five year period beginning January 1, 1983 (Tr. III, p. 10). In the instant proceeding, Cincinnati Bell has adjusted plant in service by $2,569,000 and operating expenses by $438,000 to reflect the first year effect of the phase-out (Co. Ex. 3, p. 7; Co. Ex. 14, Sched. C-3.21). Both the Staff and OCC

oppose these adjustments on the grounds that the effective date of the CPE phase-out is four months beyond the end of the test year under review (Staff Ex. 1, p. 17; OCC Ex. 5, p. 29; OCC Ex. 2, p. 8).

Although not raised by the parties to this proceeding, it has recently come to the Commission's attention that on May 28, 1982, the FCC issued an Order authorizing state commissions to implement the phase-out, at their discretion, prior to January 1, 1983 (*See Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 4-5). Administrative notice is hereby taken of that Order. Given this discretionary authority granted by the FCC, we are of the opinion that recognizing the first year effect of the CPE phase-out does not constitute a post-test year adjustment (*Ibid.*). We therefore accept the Applicant's proposal.

Cincinnati Bell Purchases

At the time of the hearing in this proceeding, AT&T owned approximately 31.2 percent of Cincinnati Bell and 100 percent of the Western Electric Company (hereinafter Western Electric), a corporation engaged in manufacturing, supplying, and repairing telephone equipment for the Bell System (Tr. II, p. 70; OCC Ex. 4, p. 4). Cincinnati Bell purchases the majority of its equipment from Western Electric and the remainder from general trade suppliers (OCC Ex. 4, p. 4). In order to evaluate the reasonableness of the costs incurred for these transactions, the Commission directed the Applicant to herein present testimony and exhibits supporting Western Electric product purchases which could have been obtained from general trade suppliers at a lower first cost (*Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR [July 15, 1981], at p. 8). The information subject to this directive was provided through Mr. Fennell.

Company witness Fennell testified on the Applicant's procurement policy and on its established procedures for implementing that policy (Co. Ex. 2). As explained by this witness, Cincinnati Bell's purchasing policy is "to award business solely on the basis of merit, without favoritism and, whenever practicable, on a competitive procurement basis, in order to achieve the lowest overall cost without impairing the quality, continuity or dependability of service or the ability to respond to emergencies" (*Id.*, at 3). Mr. Fennell further testified that after identifying potential procurement opportunities from a variety of sources, Cincinnati Bell conducts technical and economic evaluations of those products during which first cost savings, as well as other relevant tangible and intangible factors, are considered. If the Company's requirements are met, the product is then selected for use (*Id.*, at 3-9). Attached to Mr. Fennell's testimony are two exhibits on the Western Electric product purchases which could have been obtained from general trade suppliers at a lower first cost (*Id.*, at Part 1 and Part 2).

The Staff has reviewed the information Cincinnati Bell presented and has concluded that no exclusion from plant in service should be made for product procurement (Staff Ex. 1, p. 19). This conclusion is based upon the Staff's belief that the Applicant is properly conducting price comparison studies without bias in favor of Western Electric and is making the most economical selection of proper equipment (*Ibid.*).

Consumers' Counsel has entered an objection to the Staff's finding. It is the position of OCC that $27,147 should be deducted from jurisdictional plant in service because a study conducted by the Company identified six items purchased from Western Electric which have overall cost savings if they had instead been procured from general trade suppliers (OCC Ex. 4, pp. 27-28; OCC Ex. 2,

Sched. 14). Staff witness Fox disagrees with OCC for the reason that such a deduction would penalize Cincinnati Bell for purchasing the Western Electric products prior to concluding the study (Staff Ex. 11, p. 10).

In the opinion of this Commission, it is not in the ratepayers' best interest to have Cincinnati Bell automatically switch suppliers upon the introduction of a lower price product into the market or to defer all purchasing until a price comparison study is concluded (*Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at p. 12). However, if such a study shows that an item can be purchased from a general trade supplier at a lower overall cost than it can be obtained from Western Electric, then we expect the Company to purchase the general trade product and to exercise reasonable diligence in switching suppliers (*Ibid.*). Absent a showing that Cincinnati Bell is not exercising the necessary diligence to procure the general trade product, a rate base deduction for the Western Electric purchases is inappropriate (*Ibid.*). Here, since there is no such showing in the record evidence, we will reject the deduction OCC proposes and overrule the objection.

Depreciation Reserve

Section 4909.05(H), Revised Code, requires that the Commission determine the proper and adequate reserve for depreciation to be deducted from the original cost of the Applicant's used and useful property. In recognition of the vintage group remaining life accrual rates adopted in the operating expenses section of this Opinion and Order, we have adjusted the reserve as if these newly authorized accrual rates had been in effect from the beginning of the test year. We believe that it is appropriate, and consistent with the afore-mentioned statute, to match depreciation expense with date certain net plant (*Ohio Bell*

Tele. Co., Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM [April 21, 1982] at p. 11; *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at p. 10).

Working Capital

Section 4909.15(A)(1), Revised Code, requires the Commission to determine a reasonable allowance for cash working capital and materials and supplies. Cincinnati Bell, the Staff, and OCC utilized the formula method to compute their respective allowance recommendations, but arrived at different end results due to positions taken on various items which affect the working capital calculation. Since these disputed items are fully addressed in the separations and operating expenses sections of this Opinion and Order, a discussion of the specific differences between the three working capital recommendations is unnecessary. The Commission finds that the Staff's calculation of working capital should be adopted, as adjusted to account for the disposition of other issues which affect the allowance.

The following table presents in summary form our determination of the allowance for working capital to be included in rate base.

	Jurisdictional Working Capital Allowance
	(000's Omitted)
1/2 of Adjusted Operating and Maintenance Expense	$11,589
Materials and Supplies	686
Less: Customer Deposits	1,219
1/4 of Operating Taxes	7,195
Jurisdictional Working Capital Allowance	$ 3,861

Deferred Taxes

Pre-1971 Job Development Investment Tax Credits

The Staff reduced jurisdictional rate base by approximately $874,000 to reflect the date certain balance of the pre-1971 job development investment tax credits normalized by Cincinnati Bell (Staff Ex. 1, p. 23, Sched. 12). As explained by Staff witness Hensel, with the concurrence of OCC witness Miller, the reduction is appropriate because the credits represent non-investor sources of capital upon which the Company's shareholders are not entitled to earn a return (Staff Ex. 7, pp. 10-14; OCC Ex. 2, pp. 22-23). Although Cincinnati Bell objected to the deduction, it presented no direct testimony in support of its position.

In the Applicant's last rate proceeding (Case No. 80-476-TP-AIR [July 15, 1981], at pp. 7-8), we held that the date certain balance of the pre-1971 job development investment tax credits was properly deducted from rate base. Since Cincinnati Bell has failed to present any evidence demonstrating that this prior decision is incorrect, we will follow our precedent and accept the Staff's deduction. The Applicant's objection is accordingly overruled.

Lien Date Property Taxes and Vacation Accruals

The Staff additionally reduced jurisdictional rate base by approximately $8,269,000 to reflect the date certain balance of the accumulated deferred income taxes associated with lien date property taxes and vacation accruals (Staff Ex. 1, pp. 23-25, Sched. 12). This deduction is appropriate, according to both the Staff and OCC, for the same reason expressed with regard to the pre-1971 job development investment tax credits: namely, the deferred taxes represent non-investor cost-free capital (*Id.*, at 25; OCC

Ex. 2, pp. 22-23). Again, Cincinnati Bell entered an objection to the reduction, but did not address the matter through either supplemental or rebuttal testimony.

The question of whether to reduce rate base by the date certain balance of the accumulated deferred income taxes associated with lien date property taxes and vacation accruals has been previously addressed by this Commission and resolved in the affirmative (*Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 16-17). There is nothing in the instant record which justifies a departure from this precedent. We will, therefore, adopt the Staff's proposed deduction and overrule the Applicant's unsupported objection.

Rate Base Summary

In light of the foregoing discussion, the Commission finds Cincinnati Bell's jurisdictional statutory rate base, as of the date certain, to be as follows:

Jurisdictional Rate Base (000's Omitted)	
Plant In Service	$601,694
Less: Depreciation Reserve	121,974
Net Plant In Service	$479,720
Plus: CWIP	1,263
Working Capital	3,861
Less: Deferred Taxes and Other Deductions	77,569
Jurisdictional Rate Base	$407,275

OPERATING INCOME

The Applicant and the Staff each submitted an analysis of test year accounts reflecting the results of operations under the Company's existing rates. These analyses were based on four months actual and eight months projected data. The adjustments to test year revenues and expenses recommended by the parties to this proceeding are discussed on an item-by-item basis below.

Revenues

Minimum Level Pricing

Cincinnati Bell, the Staff, and OCC all adjusted operating revenues to reflect the Company's minimum level pricing increases effective March 1, 1982 (Staff Ex. 1, p. 6; OCC Ex. 2, pp. 24-26). However, the $15,109,000 adjustment proposed by the Staff and OCC was on an uncurtailed basis, whereas Cincinnati Bell's $10,574,000 adjustment was on a net of curtailment basis (Staff Ex. 1, p. 6, Sched. 3.2; OCC Ex. 2, pp. 24-26, Sched. 8.2; Tr. XI, pp. 103-104). In accordance with our discussion in the curtailment section of this Opinion and Order, the Commission finds that the minimum level pricing adjustment should be made at the uncurtailed level. The objection posed by the Applicant to the Staff's calculation should, therefore, be overruled.

Intrastate Toll Charges

As in the preceding issue, Cincinnati Bell, the Staff, and OCC each agree on the propriety of adjusting operating revenues to recognize the change in intrastate toll charges resulting from the Company's concurrence in Ohio Bell's revised toll and WATS tariffs effective April 29, 1982, but disagree on the magnitude of the adjustment. The

Staff and OCC maintain that the adjustment should be made on a curtailed basis for message toll service and on an uncurtailed basis for WATS (Staff Ex. 1, p. 7; OCC Ex. 2, pp. 24-26). Cincinnati Bell, on the other hand, proposed a net of curtailment adjustment for both services (Staff Ex. 1, p. 7).

The Company's proposed adjustment for message toll service is based on a price elasticity of -.198, which was accepted by the Commission in *Ohio Bell Tele. Co.*, Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM (April 21, 1982). The Staff believes that this elasticity is acceptable for purposes of calculating the message toll service adjustment (Staff Ex. 9, p. 19), and the Commission agrees that it should be approved.

The Company's proposed adjustment for WATS, however, presents a different question. That adjustment is based on an implied price elasticity of approximately -1.2 (*Id.*, at 18-19). According to Staff witness Wissman, the Company has not even attempted to determine the demand for WATS line service, and has presented no quantitative justification for the implied price elasticity, which indicates that a 5.1 percent increase in price will reduce the quantity demanded by approximately 6.1 percent (*Id.*, at 19). The Commission is therefore of the opinion that the Company's proposed adjustment should be rejected, and that the adjustment for WATS should be made on an uncurtailed basis, as recommended by the Staff and OCC.

Interstate Foreign Exchange Service

The Staff reduced test year operating revenues by approximately $137,000 in conformity with its recommendation that interstate FX service be allocated to the inter-

state jurisdiction, rather than to the intrastate jurisdiction as Cincinnati Bell proposed (Staff Ex 1, p. 7). While OCC supports the Staff position (OCC Ex. 2, pp. 24-26), the Applicant has objected to this adjustment. The specific opposition raised by Cincinnati Bell need not detain us. For the reasons expressed in the separations section of this Opinion and Order, we find that the Staff's adjustment is appropriate and should be adopted. The Applicant's objection is accordingly overruled.

Employee Consessions

OCC has recommended a $772,847 adjustment to operating revenues in recognition of the telephone rate concessions Cincinnati Bell provides to certain present and former employees (OCC Ex. 2, p. 27, Sched. 8.6). As described by OCC witness Miller, corporate officers, all employees with more than thirty years of company service, and all retired employees receive a 100 percent basic exchange service discount plus a reasonable allowance for toll service (*Id.*, at 27). Management employees with fewer than thirty years of service receive a 100 percent basic exchange service discount for a main station and one extension (*Ibid.*). The remaining active employees who have more than six months of service with the Company are provided basic exchange service at a 40 percent discount (*Ibid.*). These concessions, in the opinion of Mr. Miller, constitute unreasonable fringe benefits which should be the responsibility of stockholders, not ratepayers (*Ibid.*).

As this Commission has previously indicated, we agree in principle with the rationale underlying OCC's position (*Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at p. 18). However, we have also previously determined that it is not appropriate

to impute the revenues associated with employee concessions or to treat this item as an expense (*Ibid.*). Since the adjustment herein at issue is inappropriate pursuant to our precedent, and since there is no acceptable proposal before us which effectuates the stated rationale, we will overrule OCC's objection.

Budgeted Local Service Revenues

Through a revision to its standard filing requirements, Cincinnati Bell reduced test year operating revenues by $2,154,000 to reflect the differences between budgeted and actual local service revenues for an additional three months (Co. Ex. 18, Sched. C-3.22). The Staff disallowed this adjustment (Tr. XI, p. 104). As explained by Staff witness Hensel, the Applicant's local service revenues adjustment encompasses only one aspect of the budget revisions resulting from the availability of additional actual data and fails to reflect similar budget changes in other operating income items (Staff Ex. 7, pp. 4-6). Such selectivity, i.e. adjusting for one item while ignoring others, is inappropriate in the Staff's opinion (*Ibid.*). Cincinnati Bell objected to the disallowance of this adjustment, but did not pursue the matter through supplemental or rebuttal testimony. In support of its position, the Company on brief maintains that the standard filing requirements recognize the need to adjust budget data.

The Commission finds the Applicant's argument unpersuasive. For the reasons adequately discussed by Ms. Hensel, we will reject the local service revenues adjustment and overrule the Applicant's objection.

Expenses

Labor

During the pendency of this proceeding, a number of issues arose which fall under the general ambit of labor expense. From the briefs submitted by the parties, however, it is apparent that only four of these issues remain in dispute: (1) the September 1, 1982 basic wage increase for first and second level management, (2) the January 1, 1983 basic wage increase for third, fourth, and fifth level management, (3) the additional fringe benefits effective January 1, 1983, and (4) the service pension and death benefits associated with the September 1, 1982 and January 1, 1983 wage increases. Since the question of whether to recognize post-test year adjustments underpins all of these issues, they will be discussed in tandem. At the outset of this discussion, it should be remembered that the test year under review encompasses the twelve months ended August 31, 1982.

Neither the Staff nor OCC have adjusted operating expenses to reflect the four items at issue (Staff Ex. 1, p. 8; OCC Ex. 2, pp. 30-32). In the opinion of these two parties, such annualizations would constitute post-test year adjustments in contravention of the Ohio Supreme Court's decision in *Consumers' Counsel v. Public Util. Comm.*, 67 Ohio St. 2d 372 (1981) (Staff Ex. 6, p. 4; OCC Ex. 2, pp. 31-32). Not surprisingly, Cincinnati Bell disagrees with the Staff and OCC. The Applicant submits that even though the wage increases and attendant benefits became effective after the end of the test year, the Company's proposed annualizations thereof are appropriate because they recognize known and required cost changes which must be borne during the period the rates resulting from this proceeding will be in effect. Failure to reflect these annuali-

zations would, according to Cincinnati Bell, accord too much weight to the arbitrary concept which excludes post-test year adjustments and would essentially guarantee that the rate of return authorized herein will not be earned.

We are not persuaded by the Applicant's argument. In *Consumers' Counsel v. Public Util. Comm.*, cited *supra*, the Court clearly held that:

> . . . East Ohio Gas chose a test year which excluded anticipated increased costs from a new labor contract. It cannot expect the Commission to cure this omission by expanding the test year to include these later costs. Such a situation would emasculate the test year period and abrogate the principle forming the basis of the rate making structure.

In light of this precedent, which is directly on point with the wage increases and benefits at issue, we must overrule Cincinnati Bell's objections.

Customer Premises Equipment Phase-Out

Cincinnati Bell adjusted test year operating expenses by $438,000 to reflect the first year effect of removing customer premises equipment from the separations process (Co. Ex. 14, Sched. C-3.21). In accordance with our discussion in the rate base section of this Opinion and Order, we find that the Applicant's adjustment is appropriate and should be adopted.

Expensing Station Connections

Both Cincinnati Bell and the Staff adjusted test year operating expenses to recognize the expensing of station connections additions at the 75 percent level (Staff Ex. 1, pp. 17-18). Again, as discussed in the rate base section of this Opinion and Order, we find that the adjustment calculated by the Staff is appropriate and should be adopted.

Advertising Expense

Cincinnati Bell has entered the standard objection to the Staff's elimination of all corporate advertising expense ($56,251) from the calculation of test year operating expenses. In response to this objection, we reach our customary conclusion that corporate advertising does not provide a direct and primary benefit to the Applicant's customers and should, therefore, be disallowed pursuant to the Ohio Supreme Court decision in *Cleveland v. Public Util. Comm.*, 63 Ohio St.2d 62 (1980).

Lobbying Expense

Another standard objection filed by Cincinnati Bell relates to the Staff's elimination of lobbying expense ($35,000) from test year operating expenses. In support of this objection, the Applicant claims that it is both reasonable and necessary to recognize lobbying expenditures given the ever changing political environment surrounding public utilities.

As we have indicated on so many occasions as to make citation unnecessary, we consider lobbying expense to be a below-the-line item which is in no way related to the provision of service. The Applicant's objection is accordingly overruled.

Charitable Contributions

Through its filed objections, OCC maintains that the Staff erroneously failed to reduce operating expenses by the $180,293 of charitable contributions which the Applicant has sought to include in this case. OCC is apparently unaware of the miscellaneous deductions adjustment set forth in the Staff Report, whereby the Staff eliminated Account 323, Charitable Contributions, from operating in-

come (Staff Ex. 1, p. 12, Sched. 3.24; Staff Ex. 7, p. 22). Given this adjustment, OCC's objection is obviously not well-made and should be overruled.

Other Expenses, Account 675

OCC additionally proposes a $34,857 adjustment to test year operating expenses for the items charged to Account 675, Other Expenses, which represent the sponsorship of company sports teams, employee club membership fees, and contributions to various civic organizations (OCC Ex. 14, pp. 3-5). In the opinion of OCC witness Miller, these items are not properly includable for ratemaking purposes because they do not provide any direct benefit to Cincinnati Bell customers and are not necessary for the rendition of utility service (*Id.*, at 4-5; Tr. SV, pp. 103-104, 106-114). The Staff on brief concurs with OCC.

Cincinnati Bell opposes OCC's recommendation on the grounds that there is no record evidence indicating that Account 675 includes any social club fees or charitable contributions which should have instead been charged to Account 323 and treated as below-the-line items. With regard to the Pioneer Club expense, the largest item in the adjustment OCC proposes, the Applicant asserts that the club's membership consists of long-term and retired employees of the Bell System who participate in a number of activities which benefit ratepayers by improving employee morale and by sponsoring employee self-improvement education courses.

The Applicant's argument misses the point. The question now before us is not whether the expense items identified by Mr. Miller were improperly charged to Account 675 (*See* Tr. XV, pp. 106-107), but is whether the nature of those items, regardless of their classification, renders the expenses non-includable for ratemaking pur-

poses. While Cincinnati Bell peripherally addressed the appropriate issue in its discussion of the Pioneer Club expense, the assertion made is not supported by any record evidence.

After carefully considering this matter, the Commission is in agreement with the Staff and OCC. In our opinion, the sponsorship of company sports teams, the payment of membership fees, and the civic contributions provide no direct benefit to customers and are unnecessary for the rendition of utility service. Such items should, therefore, not be included in operating expenses. We accordingly find that OCC's adjustment is appropriate.

License Contract Expense

Cincinnati Bell, like other Bell System operating companies, is a party to a license contract with AT&T (Co. Ex. 1, Part 1). Pursuant to this agreement, AT&T provides a multitude of services to Cincinnati Bell in exchange for a fee based upon the Applicant's allocated share of the expenses incurred, not to exceed 2-1/2 percent of total operating revenues less uncollectibles (*Id.*, at 9-10).

As has frequently been the case in rate proceedings involving Bell companies, a number of questions have been raised concerning the extent to which license contract expense should be included in the cost of service (*See, e.g., Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR [July 15, 1981] at pp. 17-20; *Ohio Bell Tele. Co.*, Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM [April 21, 1982] at pp. 22-25; *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 29-36). The controversy does not involve the reasonableness of the amounts paid to AT&T under the license contract. Here, as in the prior cases, the evidence shows that the value of the assistance and services provided exceeds by many times

the amount Cincinnati Bell actually paid, or would have paid if the particular services had been independently obtained from another source (Co. Ex. 1, p. 10). Rather, the debate centers on whether certain of the activities funded through the license contract are of such a nature that the associated costs should not, under current rate-making practices, be passed on to the Applicant's rate-payers.

In this proceeding, the operating expenses Cincinnati Bell proposed include the $7,858,000 paid to AT&T for license contract services rendered during the test year (Co. Ex. 1, p. 9). The Staff recommends that this amount be reduced by $81,676, while OCC recommends a $2,067,000 reduction (Staff Ex. 1, Sched. 3.18; OCC Ex. 4, AFS-1). Each of these recommendations will be discussed separately below.

The Staff, as part of its investigation in *Ohio Bell Tele. Co.*, Case No. 81-436-TP-AIR (April 21, 1982), examined 2,481 individual expense items covering AT&T's license contract activities during 1981 (Staff Ex. 1, p. 10). Since the expense items reviewed are similar for both Ohio Bell and the Applicant, the Staff in this proceeding relied upon its prior findings with respect to the 1981 portion of the test year and examined an additional 2,054 expense items for the eight months of the test year in 1982 (*Id.*, at 10; Staff Ex. 11, p. 18). As a result of this combined review, the Staff recommends that the amounts attributable to memberships and subscriptions, corporate image, community and public relations, cable television, trade shows, political contributions, and various other items be excluded from allowable expenses (Staff Ex. 1, p. 10). The specific exclusion proposed by the Staff is $81,676 (*Id.*, at Sched. 3.18).

While Cincinnati Bell is opposed to the Staff's adjustment, no supplemental or rebuttal testimony was filed by the Company on this issue. The Applicant on brief maintains that it is inappropriate to apply Ohio Bell findings on license contract expense to the considerations presented in this case because Cincinnati Bell is an independent entity capable of terminating the license contract at any time through nonpayment.

The Commission of course recognizes that Cincinnati Bell is only partially owned by AT&T, whereas Ohio Bell is a wholly owned operating company. We fail to perceive, however, why this distinction should be viewed as a fatal flaw in the Staff's investigation. The Staff simply examined AT&T's 1981 license contract expenses within the context of an Ohio Bell proceeding, and then determined that the study was equally applicable to both Ohio Bell and the Applicant. There is no record evidence which refutes this determination or which indicates that license contract expenses are allocated differently between partially owned licensees and wholly owned subsidiaries. In the absence of such evidence, we do not believe that a rejection of the Staff's methodology is warranted.

With respect to the specific adjustment proposed by the Staff, we have adopted the exclusion of similar license contract expenses in previous cases (*See, e.g., Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR [June 15, 1981] at pp. 19-20; *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 33-34), and will do so again herein, with the exception of memberships and subscriptions. This exception is appropriate, in our opinion, because there is no evidence showing that these expenses relate to social, service, or athletic clubs which are normally excluded, rather than to memberships in bona fide technical, professional, or trade organizations which are

allowable expenses (*See Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at p. 33). The remainder of the Staff's adjustment properly excludes the costs associated with license contract activities unnecessary for the provision of utility service.

The $2,067,000 reduction in operating expenses recommended by OCC also encompasses a number of AT&T license contract categories; namely, normally excluded costs, product development, management and shareholder relations, other overhead, separate subsidiaries, and antitrust (OCC Ex. 4, pp. 18-20). Except for the magnitude of the adjustment, this recommendation is identical to that presented by OCC witness Skirpan and discussed in *Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA (December 22, 1982) at pp. 33-36, wherein we held that the first four categories should not be excluded from the operating expenses calculation. In light of this precedent and the lack of any evidence in the instant record which persuades us to now reach a different conclusion, we will not belabor this Order with an extended discussion of these four expense categories. For the reasons stated in the cited *Ohio Bell* decision, we find that Cincinnati Bell's operating expenses should not be reduced by the license contract categories entitled normally excluded costs, product development, management and shareholder relations, and other overhead. The treatment to be accorded the remaining two categories, separate subsidiaries and antitrust, however, does require some discussion.

The separate subsidiaries exclusion recommended by OCC witness Skirpan covers the costs incurred in the formation of new competitive Bell entities and one-half of the costs associated with the attendant transition of the Bell System structure (OCC Ex. 4, pp. 18-19). Such

an exclusion is necessary, according to Mr. Skirpan, in order to achieve an appropriate cost-sharing responsibility between the regulated and nonregulated portions of the Bell System (Tr. XIV, pp. 30-31; OCC Ex. 4, pp. 18-19). The Applicant on brief advocates rejection of this exclusion on the grounds that the one-half cost allocation is arbitrary and unsupported.

The fact that Mr. Skirpan exercised professional judgment in developing the allocation ratio for restructuring costs does not, in our opinion, constitute sufficient grounds for rejecting the separate subsidiaries exclusion, particularly since the information necessary to make a precise allocation is peculiarly within the Applicant's control but the Applicant chose not to present it. Further, it is interesting to note that Cincinnati Bell's argument is confined to the calculation of the exclusion; the propriety of excluding the separate subsidiary related costs is not specifically challenged. With regard to this latter subject, we believe that ratepayers should not be required to cross-subsidize the restructuring of the Bell System or the creation of new competitive Bell entities. Such a cross-subsidization would vitiate the intent of divestiture and would result if the separate subsidiaries exclusion is not made. We will, therefore, adopt the exclusion as calculated by Mr. Skirpan.

The final license contract expense category encompassed by the OCC sponsored adjustment is antitrust costs. According to Mr. Skirpan, an exclusion of these costs is appropriate because they are non-recurring in nature and are unnecessary to the provision of intrastate utility service (OCC Ex. 4, p. 19). Not surprisingly, Cincinnati Bell also opposes this exclusion.

As the Commission indicated in the afore-cited *Ohio Bell* decision (at p. 36), we do not dispute the proposition

that the antitrust costs are reasonable and necessary business expenses, however, we are not convinced that the incurrence of these costs will remain at the same level in the post-divestiture period. Consequently, we find that the license contract antitrust costs, because they are nonrecurring in nature, should be excluded from the Applicant's operating expenses in accordance with the calculation Mr. Skirpan performed.

Depreciation Expense

While a substantial portion of the record compiled in this case was devoted to the topic of depreciation expense, an extensive discussion of this issue is unnecessary. It has recently come to the Commission's attention that on December 22, 1982, the FCC in Docket No. 82-581 found that where it prescribes depreciation rates and methods for telephone companies, state utility commissions are precluded from using different rates and methods in their intrastate ratemaking proceedings. It has additionally come to our attention that by final Order issued on December 14, 1982 in Docket No. 82-542, the FCC approved the remaining life accrual rates and equal life group (hereinafter ELG) accrual rates requested by the Applicant herein, effective June 1, 1982. We hereby take administrative notice of both FCC actions. In light of these two FCC decisions, and in the absence of any judicial determination to the contrary, this Commission feels compelled to adopt the Applicant's proposed depreciation rates. The depreciation expense should, therefore, reflect the adoption of these represcribed remaining life and ELG accrual rates. If the FCC's Order on preemption is overturned by a court of law, however, this Commission is willing to reconsider the matter, since we would have otherwise retained the whole life methodology in accordance with our prior de-

cisions (*See, e.g., Ohio Bell Tele. Co.*, Case Nos. 81-1433-TP-AIR and 82-342-TP-ATA [December 22, 1982] at pp. 22-29).

F.I.C.A. Taxes

For purposes of calculating F.I.C.A. taxes, the Staff utilized a wage base of $32,400 (Staff Ex. 1, Sched. 3.21d). Cincinnati Bell has objected to this calculation and has requested that the Commission take administrative notice of the $35,700 F.I.C.A. taxable wage base effective January 1, 1983. The new wage base should be utilized in computing test year F.I.C.A. taxes, according to the Company, because it is a known and required cost change which must be borne in the period during which rates ordered as a result of this proceeding will be collected. Both the Staff and OCC oppose Cincinnati Bell's adjustment on the grounds that implementation of the $35,700 wage base is speculative (*See* Staff Ex. 7, p. 7).

We disagree with the Staff and OCC. After reviewing the determination by the Secretary of Health and Human Services, 47 Fed. Reg. 51003 (November 10, 1982), it is the opinion of this Commission that the $35,700 wage base represents the authorized figure to be used for F.I.C.A. tax purposes. We will accordingly take administrative notice of the Secretary's determination and sustain the Applicant's objection.

Gross Receipts Taxes

For purposes of calculating gross receipts taxes, the Staff deducted the $371,327 excise tax overrecovery collected by the Applicant (Staff Ex. 1, p. 11, Sched. 3.21c; Staff Ex. 7, pp. 7-9). While OCC supports the Staff's calculation (OCC Ex. 2, p. 41), Cincinnati Bell opposes

the deduction for the reason that the over-collection occurred only once and, assuming a rate proceeding every two years, the maximum reduction should be limited to one-half of the amount deducted by the Staff. We agree. Since the referenced two-year assumption also underlies rate case expense, we believe that the Applicant's position on this issue is the more reasonable method for accomplishing the refund and should be adopted.

One additional matter in this area needs to be addressed. The Staff's gross receipts tax calculation is based upon a tax rate of 4.25 percent, which represents the permanent portion of the various excise taxes in effect (Staff Ex. 1, p. 11, Sched. 3.21c). If this tax rate is adopted by the Commission, Staff witness Hensel recommends that Cincinnati Bell be permitted to file a surcharge tariff for the recovery of the remaining temporary .50 percent (Tr. XI, p. 139). None of the other parties to this proceeding have addressed Ms. Hensel's recommendation. Given this apparent apathy, we find that the 4.25 percent excise tax rate should be reflected in the Applicant's base rates and that Cincinnati Bell should file a surcharge tariff for the recovery of the .50 percent temporary tax.

Operating Income Summary

Consistent with the foregoing discussion, the Commission finds the Applicant's jurisdictional operating income for the twelve months ended August 31, 1982, the test period in this proceeding, to be as set forth on the following schedule:

Adjusted Operating Income
(000's Omitted)

Operating Revenues	
Gross Operating Revenues	$268,484
Uncollectibles	1,003
Net Operating Revenues	$267,481
Operating Expenses	
Operation and Maintenance	$139,062
Depreciation and Amortization	40,836
Other Taxes	29,598
Income Taxes	18,666
Total Operating Expenses	$228,162
Net Operating Income	$ 39,319

PROPOSED INCREASE

A comparison of jurisdictional test year operating revenue after uncollectibles of $267,481,000 with allowable jurisdictional expenses of $228,162,000 indicates that under its present rates the Applicant realized income available for fixed charges in the amount of $39,319,000 based on adjusted test year operations. Applying this dollar return to the jurisdictional rate base of $407,275,000 results in a rate of return under present rates of 9.65 percent. This rate of return is well below that recommended as reasonable by either of the expert witnesses presenting testimony on this subject and, accordingly, the Commission must conclude that the Company's present rates are insufficient to provide it reasonable compensation for the telephone service rendered customers affected by the application. Rate relief is clearly required at this time.

Under the rates proposed by the Applicant, additional gross annual revenues of $42,684,000 would have been realized based on test year operations as analyzed herein. On a pro forma basis, which assumes necessary expense adjustments calculated in a manner consistent with the Commission's findings, this proposed increase would have yielded an increase in jurisdictional net operating income of $21,986,000, resulting in income available for fixed charges of $61,305,000. Applying this dollar return to the jurisdictional rate base results in a rate of return of 15.05 percent. Although it is apparent that present rates are inadequate, the increase proposed results in a rate of return in excess of that recommended by the expert witnesses. Thus, further analysis is required to establish a reasonable earnings opportunity for this company.

RATE OF RETURN

Two witnesses offered cost of capital analyses to be considered as evidence by the Commission in establishing a fair rate of return for purposes of this proceeding. Dr. Z. Lew Melnyk, testifying on behalf of Cincinnati Bell, determined that the weighted average cost of capital for the Company was in the range of 13.6 percent to 14.5 percent, and recommended that the Commission authorize an allowed return of between 14.0 percent and 14.5 percent (Co. Ex. 7, p. 38). Staff witness Wissman, as a result of his study, arrived at a cost of capital recommendation encompassing a 12.4 percent to 13.0 percent range (Staff Ex. 9, p. 3). Although the disparity between the Company and Staff positions lies primarily in the cost of common equity area, there are certain other matters which must first be addressed.

Capital Structure

As the starting point for their individual cost of capital analyses, both Dr. Melnyk and Mr. Wissman employed the actual capital structure of Cincinnati Bell (Co. Ex. 7, pp. 16-17; Staff Ex. 9, p. 3). Dr. Melnyk, however, relied upon the date certain capital structure of 41.5 percent debt, including short-term debt, 3.1 percent preferred stock, and 55.4 percent common equity, whereas Mr. Wissman utilized the actual capital structure as of September 30, 1982, which consisted of 36.8 percent long-term debt, 2.3 percent preferred stock, and 60.9 percent common equity (*Ibid.*).

Cincinnati Bell on brief concedes that the updated capital structure more accurately represents the cost of capital it will incur during the period for which rates are being set. The Company further indicates a recognition that the exclusion of short-term debt from the capital structure is consistent with prior Commission decisions. For these reasons, Cincinnati Bell now accepts the capital structure identified by Mr. Wissman.

Given this concurrence with the Staff's position, we find that the September 30, 1982 capital structure of the Applicant, excluding short-term debt, should be adopted for purposes of determining a fair and reasonable return in this proceeding.

Cost of Debt and Preferred Stock

As a result of Cincinnati Bell's acceptance of the capital structure utilized by Mr. Wissman, no dispute exists with respect to the cost rates to be assigned the long-term debt and preferred stock components. Both the Applicant and the Staff now recommend that the actual embedded costs of these senior securities, as of

September 30, 1982, be used in determining the weighted cost of capital (*See* Staff Ex. 9, pp. 3-4). The Commission accordingly finds that the embedded cost of long-term debt is 8.87 percent and that the embedded cost of preferred stock is 8.41 percent (*See Id.*).

Cost of Common Equity

As mentioned at the outset of this section, the primary controversy in the rate of return area centers on the cost to be assigned the equity component of the capital structure. Unlike the costs of debt and preferred stock which are derived through a largely mechanical process, the cost of common equity can only be estimated. A variety of valid methods exist for obtaining the estimation, but in the final analysis, the results of each approach are greatly influenced by the judgments and assumptions interjected by the sponsoring witness. Our selection of one recommendation over another does not signify that the proposal of any particular witness was "wrong," except in those instances where internal inconsistencies render the proposal unacceptable under the sponsor's own approach, but merely indicates that the Commission, in a necessary exercise of our discretion, must adopt the recommendation we believe is the most appropriate in light of the evidence presented. The two recommendations offered for our consideration herein are a range of 17.6 percent to 18.4 percent by Company witness Melnyk and a range of 14.59 percent to 15.55 percent by Staff witness Wissman (Co. Ex. 7, p. 35; Staff Ex. 9, p. 3). Dr. Melnyk's cost of equity range results from his application of the discounted cash flow (hereinafter DCF) methodology, as "verified" by the risk premium approach, while Mr. Wissman's range is based solely upon a DCF analysis (Co. Ex. 7, pp. 23-24; Staff Ex. 9, p. 5).

The risk premium methodology utilized by Company witness Melnyk need not detain us. As previously mentioned, Dr. Melnyk's reliance upon the cost of equity derived from his risk premium calculations was limited to testing the reasonableness of the results obtained through his DCF analysis (Co. Ex. 7, p. 35). Thus, no witness has sponsored, nor has any party advocated, the adoption of the risk premium methodology to independently determine the cost of Cincinnati Bell's equity.

Since the risk premium methodology has not been offered for consideration, it is apparent that our decision as to the appropriate return on equity will necessitate a choice between the DCF recommendations made by Dr. Melnyk and Mr. Wissman. Under the DCF formula, the cost of equity is equal to the current dividend yield plus the expected rate of growth in dividends (Staff Ex. 1, pp. 31-32). Although both witnesses applied this basic formula, their quantifications of the yield and growth components were derived through materially different approaches.

With regard to the yield component, Company witness Melnyk stated his belief that the anticipation of continued high interest rates on borrowed capital will cause common stockholders to also demand correspondingly increased rates of return (Co. Ex. 7, p. 28). This anticipation, coupled with his perceptions of the economy, the capital market, trends in dividend yields, the Company's capital structure, and continued pressure on profits and their growth rates, led Dr. Melnyk to exercise his professional judgment and to conclude that 10 percent is the appropriate yield component (*Id.*, at 28-29; Tr. V, pp. 8-9). In contrast to the foregoing approach, Mr. Wissman computed a yield specific to Cincinnati Bell by dividing the current annualized dividend of $2.72 per

share by the $28.22 average price per share of common stock for the twelve months ended September 30, 1982 (Staff Ex. 1, p. 29; Staff Ex. 9, p. 4). Mr. Wissman's calculation produced a recommended yield component of 9.64 percent.

Based upon our review of these two diverse approaches, we believe that the analysis performed by Mr. Wissman is a more fitting application of the DCF formula and that his yield determination should therefore be adopted. Dr. Melnyk's approach is unacceptable, in our opinion, because it distorts the concept of a discounted cash flow analysis. As we have indicated on so many occasions as to make citation unnecessary, one principal advantage of the DCF methodology is that it is company specific. In other words, the DCF formula estimates a given company's cost of equity by focusing on its particular market data. Such data, as utilized by Mr. Wissman, not only implicitly reflects the types of considerations underlying Dr. Melnyk's professional judgment, but provides a greater degree of objectivity and reliability. Thus, elevating general market perceptions above company specific data, as Dr. Melnyk has done, is highly questionable. This witness's approach is further suspect because it produced an expected dividend yield rather than the current yield component traditionally associated with a DCF analysis (*See* Staff Ex. 9, p. 9).

With regard to the growth component of the DCF formula, Company witness Melnyk examined the following factors: projected trends in operating revenues and costs, projected growth in assets, capital structure, trends in earnings and dividends, future capital needs, and economic and market conditions (Co. Ex. 7, pp. 29-30). As a result of this examination, Dr. Melnyk selected a range of 6.75 percent to 7.50 percent as a conservative basis for deter-

mining the appropriate growth rate (*Id.*, at 30). Staff witness Wissman, on the other hand, estimated the growth component by using the "b x r" approach, with "b" equaling the retention rate of earnings and "r" representing the earnings on the common equity funds retained (Staff Ex. 1, p. 27). For the eight year period of 1975 through 1982, Mr. Wissman's computations indicate an average "b x r" of 6.05 percent (*See* Staff Ex. 9, p. 6). However, because the retention rate and average return on common equity are of similar magnitude for the years 1975-1976 and 1980-1982, but are considerably higher for the years 1977-1979, the Staff witness believes that the average "b x r" value is not representative of the growth rate investors can reasonably expect in the future (*Id.*, at 6-7). This belief, coupled with the Applicant's ability to internally generate most construction financing, the uncertain impact of pending antitrust litigation, the low population growth in Cincinnati Bell's service area, and the possibility of increased competition in vertical and toll services, lead Mr. Wissman to conclude that 4.50 percent is a reasonable estimate of the growth rate (*Id.*, at 7).

In assessing these recommendations, several observations we have made on prior occasions must be kept in view. First, although the growth component of the DCF formula actually represents "expected growth," a quantity not susceptible to empirical measurement, historical evidence should not be ignored in determining the dividend growth investors may realistically anticipate for a given firm. Second, in selecting the most relevant evidence for purposes of establishing an appropriate growth factor, it is important to recognize that a review encompassing only the dividend history of a company may not always provide a sufficient basis for estimating dividend growth. The earnings history must also be evaluated.

Based upon our review of the widely divergent approaches utilized by the witnesses to estimate growth, we find that Mr. Wissman's methodology most closely dovetails with the foregoing observations and that his recommended growth component of 4.5 percent should be adopted. In reaching this conclusion, we are not unmindful of Cincinnati Bell's criticism that Mr. Wissman departed from the five year "b x r" average which the Staff has utilized, and which the Commission has adopted, in prior cases. It is our view that the "departure" is fully justified by the record compiled in this proceeding. A growth component derived from a five year average "b x r" was adopted in prior Opinion and Orders because it represented a reasonable estimation of the expected growth rate in dividends per share (*See, e.g., Ohio Bell Tele. Co.,* Case No. 79-1184-TP-AIR [December 3, 1980] at p. 36). Here, however, the use of such an average would clearly lead to an unreasonable and unrepresentative result given that the record evidence discloses "b x r" values for 1975 through 1982 of .0457, .0453, .0931, .1016, .0785, .0434, .0374, and .0389, respectively (Staff Ex. 9, p. 6). With regard to the approach taken by Company witness Melnyk to determine the growth rate, we are not convinced that the range produced is reliable since it is primarily based upon data that is neither specific to Cincinnati Bell nor more recent than 1980 (*See Id.*, at 9-10).

Adjustments to the Base Line Cost of Equity

Having now adopted a yield component of 9.64 percent and a growth component of 4.50 percent, we find the Applicant's base line cost of equity to be 14.14 percent. Both Cincinnati Bell and the Staff concur that some adjustment to this base line cost is necessary to account

for issuance costs, dilution, and the need for flexible financing, but disagree slightly on the magnitude of the adjustment required. Staff witness Wissman recommends that the customary adjustment factors of 3.2 percent and 10 percent be applied, which produces a cost of equity ranging between 14.59 percent and 15.55 percent, whereas Company witness Melnyk supports a 5 percent adjustment (Staff Ex. 9, p. 12; Co. Ex. 7, p. 32). OCC and the City, on the other hand, oppose any adjustment to the base line cost of equity on the grounds that the Applicant has not issued common stock to the public since 1965 and does not contemplate a public offering during the next few years (*See* Tr. II, pp. 126-127). If such an adjustment is granted, however, these two intervenors maintain that the low end of the Staff's recommendation should be utilized.

This Commission has addressed the propriety of the adjustment at issue in considerable detail on a number of prior occasions, and we perceive no useful purpose in reiterating those discussions. For the same reasons as set forth in *Dayton Power and Light Co.*, Case No. 80-687-EL-AIR (July 15, 1981) at pp. 34-36, we find that an adjustment to the base line cost of equity is appropriate and that the Staff's proposal, which encompasses Dr. Melnyk's recommendation, should be adopted herein. We further find that the record evidence adequately countervails the intervenors' charge that no adjustment is necessary due to the lack of public stock offerings by the Applicant (*See* Tr. V, pp. 83-96; Tr. VIII, pp. 165-175).

As previously noted, the adoption of the foregoing adjustment produces a recommended cost of equity range of 14.59 percent to 15.55 percent (*See* Staff Ex. 9, p. 12). In selecting a point within this spread, we have generally begun our deliberations at the midpoint of the range, and

then moved in one direction or another if the particular record under review evidences factors which we, in our discretion, believe should be taken into consideration. In the instant case, the operative factors we identified affect the point selection in opposite directions. A cost of equity lower than the midpoint is supported by the facts that Cincinnati Bell has an Aaa bond rating, has the highest stock safety and stability ratings awarded by *Value Line,* has the second highest *Value Line* rating for overall corporate financial strength, does not rely upon frequent public stock offerings to generate funds, and will experience less risk in the future as a consequence of the enhanced possibility of full capital recovery resulting from the Commission's adoption of vintage group remaining life depreciation accrual rates (Tr. VIII, pp. 115-119; Tr. II, pp. 126-127). Selecting a cost of equity above the midpoint, by contrast, is supported by the excellent service the Applicant provides and the uncertainty surrounding the impending divestiture (Staff Ex. 1, pp. 70-74). After assessing these considerations, we believe that the factors justifying a cost of equity lower than the midpoint outweigh the countervailing factors. We accordingly find that the point between the first and second quartiles of the recommended range, or 14.83 percent, is the appropriate cost of equity.

Rate of Return Summary

Applying a cost of equity of 14.83 percent to the equity component of the capital structure approved herein produces, when combined with our earlier findings relative to long-term debt and preferred stock, a weighted cost of capital of 12.50 percent. The Commission is of the opinion that a 12.50 percent rate of return is sufficient to provide the Applicant reasonable compensation for the telephone service it renders customers affected by this application.

Cost of Capital Summary
(Percentages)

	Capital Structure	Cost Rate	Weighted Cost
Long-Term Debt	36.8%	8.87%	3.3%
Preferred Stock	2.3%	8.41%	.2%
Common Stock	60.9%	14.83%	9.0%
Overall Cost of Capital	100%		12.50%

AUTHORIZED INCREASE

A rate of return of 12.50 percent applied to the jurisdictional rate base of $407,275,000 approved for purposes of this proceeding results in an allowable dollar return of $50,909,000. Certain items must be adjusted if the gross revenues authorized are to produce this dollar return. These adjustments, which have been calculated in a manner consistent with the findings herein, result in an increase in federal income tax and Kentucky income tax of $10,031,000, in state excise tax of $796,000, and in the allowance for uncollectibles of $83,000. Adding the approved dollar return to the total allowable expenses results in a finding that Applicant is entitled to place rates in effect which will generate $290,984,000 in gross annual operating revenues before uncollectibles. This represents an increase of $22,500,000 on an uncurtailed basis over the revenues which would be realized under the Applicant's current rate schedules.

CURTAILMENT

Basic economic theory indicates that an increase in the price of a product will generally lead to a decrease in the quantity demanded, assuming that all other things remain equal. In practice, of course, it is unlikely that

all other things will remain equal. Nevertheless, it is clearly possible, through the use of econometric models, to calculate price elasticity coefficients which reasonably predict the reduction in quantity demanded which would result from a given percentage increase in price. Such a reduction in the quantity demanded is referred to as demand repression (or curtailment), and the corresponding reduction in revenue is referred to as revenue curtailment.

The Company proposes an adjustment of $6,517,000 to offset anticipated revenue curtailment resulting from the rate increases to be approved in this proceeding (Co. Ex. 8, p. 12). The Company also proposes an adjustment of $4,495,000 relating to items which are subject to minimum level pricing, as a result of the Staff's recommendation that revenues from those items be expressed on an uncurtailed basis (Co. Ex. 8a, p. 5; Staff Ex. 1, p. 6). The Staff recommends a curtailment adjustment of $2,667,000 (Staff Ex. 9, p. 17). Both the Company and the Staff agree that those amounts must be adjusted if the Commission ultimately grants less than the total revenue increase requested by the Company (Tr. V, p. 141; Tr. VIII, p. 104). OCC and TSTA argue that the proposed adjustments for curtailment should be rejected (OCC Ex. 6, p. 61; TSTA Ex. 1, pp. 42-44).

In developing the Company's proposed adjustment, Company witness Chang used econometric models for each of seven basic categories of service: (1) Residence Basic Exchange, (2) Residence Vertical, (3) Residence Non-Recurring, (4) Business Basic Exchange, (5) Business Vertical, (6) Business Non-Recurring, and (7) Private Line. The Residence Basic Exchange model consists of one party flat rate service, two party flat rate service, and two party message rate service. The Business Basic Exchange model includes one party flat rate business ser-

vice, one party message rate business service, flat rate trunk service, and message trunk service. Station sets associated with basic services were excluded, leaving only the access line portion in the basic exchange services. The Residence Vertical model primarily consists of Touch-Tone, Custom Calling, Public Listing, and other miscellaneous services. The Business Vertical model includes private branch exchange service, Centrex service, key telephone system service, and the types of services included in the Residence Vertical model. The Residence and Business Non-Recurring models consist of all one-time charges (except those applicable to private lines), including initial product charges, installation charges, and other charges incurred in order to establish service. The Private Line Model includes burglar alarms, dataphones, audio and video program transmissions, and other voice and data transmissions involving dedicated circuits (Co. Ex. 8, pp. 4-5; Co. Ex. 8a, p. 1).

For each of the models, significant factors that explain variations in demand were specified. The demand for residence basic exchange service was found to be a function of its own price, personal income, the number of mortgages, habit, and seasonality. The demand for residence vertical service was found to be a function of its own price, total employment, and a habit variable. The demand for residence non-recurring service was found to be a function of its own price, employment, the number of mortgages, the percent of non-Phone Center service orders, a binary variable which represented the sudden drop in the economy during the second quarter of 1980, and seasonality. The demand for business basic exchange service was found to be a function of its own price, gross national product, habit, and seasonality. The demand for business vertical service was a function of price, non-agricultural employ-

ment, and habit. The demand for Business non-recurring service was a function of its own price, non-agricultural employment, and seasonality. Private line demand was a function of price, non-agricultural employment, and habit (*Id.*, at 6-7, 9-10).

In all seven models, deflated revenues were used to represent the quantity of demand (*Id.*, at 7). This was accomplished by dividing total revenues by appropriate price indexes (*Ibid.*). Revenues were used to represent demand because the Company's services, such as one-party flat rate or two-party message rate service, are not supplied in equal units (Tr. V, p. 126).

The price elasticity coefficients were calculated using techniques of multiple regression. Revenue curtailment was then calculated by multiplying the percent repression, expressed in the price elasticity coefficient, by the increased revenue which was expected to result from this rate proceeding (Co. Ex. 8, pp. 6-7). The results of those calculations are set forth in the following table:

	Price Elasticity	Revenue Curtailment
Residence Basic Exchange	–.055	1,198,000
Residence Vertical	–.249	157,000
Residence Non-Recurring	–.368	662,000
Business Basic Exchange	–.069	981,000
Business Vertical	–.327	1,885,000
Business Non-Recurring	–.397	645,000
Private Line (Intra-Exchange)	–.277	868,000
Private Line (Inter-Exchange)	–.280	121,000
		6,517,000

(Co. Ex. 8, Part 1, p. 1)

Statistical tests were subsequently applied to test such factors as the explanatory power of the equations in the models and the statistical significance of the individual explanatory variables (Co. Ex. 8, pp. 11-12). According to Company witness Chang, all of the models showed "excellent fit" and all of the variables used to explain demand passed the significance t-test at the 95% confidence level (*Id.*, at 12; Tr. V, p. 132).

In an attempt to provide further verification of the estimate of curtailment in basic exchange services, the Company used a tracking model which tracked and analyzed access line loss following its 1981 rate case (*Id.*, at 8-9; Tr. V, pp. 110-111). The results of that analysis, according to witness Chang, support the order of magnitude of the price elasticity coefficient obtained by the model (Co. Ex. 8, p. 8).

In order to complete the Company's curtailment analysis, Company witness Sigmon supplied estimates of the cost savings which will be realized as a result of anticipated reductions in demand (Co. Ex. 10, pp. 17-19; Part 4, p. 1).

The Staff originally opposed the Company's proposed curtailment adjustment (Staff Ex. 1, p. 28). After subsequent review, however, the Staff became convinced that the Company's models were consistent with economic theory, that the method used to derive test year elasticities was acceptable, and that the resulting revenue curtailment was calculated correctly (Staff Ex. 9, p. 16; Tr. VIII, p. 149). As a result, the Staff modified its earlier position and recommended that the Company's proposed adjustments for five of the seven service categories be approved. The Staff continues to oppose the adoption of

any curtailment adjustment for the two basic exchange categories. While conceding that there may well be a small amount of curtailment in these areas, Staff witness Wissman argues that its magnitude is difficult to determine, and that consumers will generally respond to price increases by adjusting their usage, and not by totally discontinuing their telephone service (Staff Ex. 1, p. 28; Tr. VIII, p. 76). The Staff also expressed concern over the fact that the Company's econometric models failed to include a measure of population (Staff Ex. 9, p. 16).

The Staff further recommends rejection of the Company's proposed adjustment which relates to items which are now subject to minimum level, or flexible, pricing (*Id.*, at 18). In essence, the Staff notes that the Company sets the prices for those items, and argues that the Company should consider anticipated curtailment in establishing those prices (*Ibid.*; Tr. VIII, p. 81). The Staff also notes that flexibly-priced products were not included in this rate case, and argues that the allowance of the adjustment would require other services to subsidize those products (Staff Ex. 9, p. 18).

OCC witness Fish and TSTA witness Montgomery have criticized the Company's proposed adjustment on essentially similar grounds. In essence, both witnesses contend that past experience fails to support the Company's proposed adjustment (*See generally* OCC Ex. 6, pp. 47-51; TSTA Ex. 1, pp. 42-44). Mr. Montgomery notes that demand for the Company's services has generally continued to increase (TSTA Ex. 1, p. 43) and Dr. Fish claims that past increases in price have not produced corresponding decreases in revenue (Tr. XIV, pp. 120-120a). Both witnesses basically conclude that revenue curtailment has not occurred in the past, and is therefore not likely to occur in the future (OCC Ex. 6, pp. 44, 59-61; TSTA Ex. 1, pp. 43-44).

These arguments are unconvincing. The threshhold problem is perhaps one of semantics, since witnesses Fish and Montgomery have either explicitly or implicitly defined curtailment differently than the Staff. The Staff defines curtailment as the reduction in the quantity of an item demanded (and the corresponding loss of revenue) which results from a given increase in price, *assuming that all other things remain equal* (Tr. VIII, p. 136). Witnesses Fish and Montgomery, on the other hand, stress that in actuality, all other things will not remain equal, and suggest that curtailment should be defined in terms of the Company's overall revenues (OCC Ex. 6, pp. 44, 48-50; Tr. XIV, p. 131; TSTA Ex. 1, pp. 43-44; Tr. XII, p. 79). Dr. Fish specifically suggests that curtailment occurs only when the Company's overall revenues increase at a rate which is less than the overall percentage increase in price (OCC Ex. 6, p. 44).

It is undisputed that during the period reviewed by witness Chang, the Company's revenues increased by 119% while its prices increased by only 68 percent (OCC Ex. 6, p. 49). It does not follow, however, that demand repression—or curtailment, as the Staff defines it—has not occurred. The Company's overall revenues are affected by a variety of factors other than price, such as population shifts, demographic changes, income, and employment (Tr. V, p. 165; Tr. VIII, p. 136; Tr. XII, p. 76; Tr. XIV, pp. 120, 134). Consequently, as both Company witness Noble and Staff witness Wissman explained, the mere fact that prices and revenues have both risen does not indicate an absence of curtailment (Tr. V, p. 170; Tr. VIII, pp. 136-138). On the contrary, the Company's tracking model clearly indicates that it has experienced both demand repression and revenue curtailment in the past (Tr. V, p. 167; Co. Ex. 8, pp. 8-9, Part 3; Co. Ex. 8a, pp. 8-10).

Witnesses Fish and Montgomery further suggest that such potentially offsetting factors as population growth and demographic shifts should be considered in determining the need for a curtailment adjustment (Tr. XIV, pp. 120, 154, 191; Tr. XII, pp. 76, 79; TSTA Ex. 1, pp. 43-44). Mr. Montgomery specifically suggests the use of the various factors considered by the Company in making its two-year projections for budget purposes (TSTA Ex. 1, pp. 43-44; Table 21). The Commission cannot agree that this would be appropriate. The purpose of the curtailment adjustment is simply to offset anticipated revenue curtailment resulting from the price increases to be approved in this case, and thereby afford the Company a reasonable opportunity to collect its authorized revenues (*See* Tr. VIII, pp. 155-157). The price increases approved in this case are known with certainty at the time the new tariffs are approved, and the record indicates that the resulting demand repression can be estimated with reasonable precision. By contrast, the other factors, which may either increase or decrease future revenues, are beyond the control of the Commission and are not known with any reasonable degree of certainty at the time the new rates are approved. In essence, these factors, such as population shifts or demographic changes, simply constitute part of the overall business risk which the Company must face on a day to day basis. We are not persuaded that it would be appropriate to consider such factors in determining an appropriate curtailment adjustment, and even if we were, the record in this case does not provide an adequate basis for doing so. The intervenors' arguments on this point should therefore be rejected.

OCC also argues that the Company's models are not properly specified, because six of the seven models omitted income as an independent variable (OCC Ex. 6, p. 54). It

is true, as OCC asserts, that income and price are two of the most important determinants of consumers' purchases (Tr. V, p. 148). However, the Company applied a number of statistical tests to its models (Co. Ex. 8, pp. 6-7), and for each service except Residence Basic Exchange, the Company found variables other than income which better explain variations in demand (Tr. V, pp. 116-117, 160-161). For this reason, the omission of income as an independent variable should not be considered a misspecification of the Company's models.

OCC further contends that the Company's models are circular, because the quantity demanded (which is represented in the models by deflated revenues) is included as both a dependent and an independent variable. In support of that contention, OCC cites *Ohio Edison Co.*, Case No. 81-1171-EL-AIR (November 3, 1982). The situation presented in *Ohio Edison* is clearly distinguishable from the facts at hand. The circularity problem in that case arose because Ohio Edison employs an hours' use rate, under which price affects demand *and* demand affects price. There is nothing in the record which even suggests that a similar problem exists in this proceeding.

OCC then contends that the models are flawed because they were not based on marginal price, again citing *Ohio Edison Co., supra.* Once again, the *Ohio Edison* case is clearly distinguishable. For an electric utility, such as Ohio Edison, which employs declining block or hours' use rates, there can be a significant difference between marginal price and average price. There is no indication in the record of this case that there is any material difference between the average and marginal prices of the local telephone services offered by Cincinnati Bell.

Finally, OCC witness Fish argues that the models are deficient because they ignore the effects of cross-elasticity

(OCC Ex. 6, pp. 54-55). The Staff concurs in that argument, insofar as it relates to the proposed adjustments for basic exchange services.

Cross-elasticity is generally defined as the percentage change in the quantity demanded of one product which results from a one percent change in the price of another product (OCC Ex. 6, p. 55; Tr. V, pp. 119-120). If, for example, the Commission approved a given percentage increase in private line rates, a private line customer might choose to discontinue that service and subscribe to lower-cost basic exchange service (*See* Tr. VIII, pp. 87-88). Such shifts would obviously increase the demand for basic exchange service, which would partially offset curtailment resulting from price increases in that area. It is that effect which was not explicitly considered in the Company's econometric models.

It should be noted, however, that the failure to consider cross-elasticities would not justify a rejection of all seven of the Company's models. As Staff witness Wissman explained, the shift in the above-cited example might suggest that the revenue curtailment contained in the Basic Exchange model is overstated, but it would not support rejection of the private line adjustment (Tr. VIII, pp. 162-163). In other words, if the omission of cross-elastic effects has caused an overstatement of revenue curtailment, the overstatement would only involve categories (such as Business Basic Exchange) which provide substitutes for services whose prices are being increased.

Furthermore, although the Company's models did not explicitly consider such factors, Company witness Chang testified that she performed a number of tests to determine the effects of cross-elasticity, and found that those effects were not significant (Tr. V, pp. 141-144). Consequently,

the Commission does not believe that the omission of cross-elastic effects constitutes a significant defect in the Company's models, and even if it did, it would appear to affect only those categories which include the basic exchange services.

After carefully considering all of the relevant evidence on this issue, the Commission concludes that the Company's econometric models are basically sound, and that the proposed curtailment adjustments for the Residence Vertical, Residence Non-Recurring, Business Vertical, Business Non-Recurring, and Private Line categories should be approved. Those adjustments should, of course, be modified to reflect the revenue increase actually authorized for each category in this proceeding. The Commission agrees with the Staff's recommendation that the adjustments for basic exchange services should be rejected, partly because of the various factors cited by the Staff (particularly the relative magnitude of the curtailment in those areas and the difficulty of measuring it), and partly because of the existence of the newly-approved Optional Measured Rate Service. That service, which was not considered in the models, offers customers a new, lower-cost alternative to flat rate service. To the extent that customers select the new alternative instead of discontinuing service entirely, as they might otherwise have done, the Company's models would appear to overstate curtailment in the basic exchange area. Finally, the Commission finds that the Company has failed to justify its proposed adjustments for items subject to minimum level pricing. The revenues from that category should therefore be expressed on an uncurtailed basis.

RATES AND TARIFFS

A number of issues have been raised in this proceeding concerning the allocation of revenue responsibility and the design of specific rates. These issues are discussed under appropriate subheadings below.

Cost Studies and Revenue Distribution

The Company submitted two types of cost studies in this proceeding. Its prospective resource cost studies were designed to determine the anticipated costs of providing service during the three-year planning period beginning in 1982 and ending with 1984 (Co. Ex. 10, pp. 3-4; Tr. VI, pp. 7-9). Its embedded direct analysis (EDA), by contrast, was based on costs actually incurred in the past (Co. Ex. 10, p. 8; Tr. VI, pp. 24-25). The Company's proposed rates for private line services were essentially based on the prospective resource cost studies (Co. Ex. 11, p. 18). Where no cost studies were available, the Company generally proposed a 30 percent increase, because its proposed increase in intrastate revenues, exclusive of toll revenues and tariff items associated with minimum level pricing, was approximately 30 percent (*Id.*, at 6, 18). In some instances, other considerations were used (*Id.*, at 6). The balance of the proposed revenue increase was distributed among the basic exchange services (*Ibid.*).

The intervenors have presented extensive testimony criticizing the Company's prospective resource cost studies (*See generally* Alarm Intervenors Ex. 1 and TSTA Ex. 1), but there is clearly no need for a lengthy discussion of this issue. The Commission has repeatedly rejected the use of such studies in the past, *See, e.g., Ohio Bell Tele. Co.*, Case No. 81-1433-TP-AIR (December 22, 1982); *Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR (May 19, 1981); and *Ohio*

Bell Tele. Co., Case No. 81-436-TP-AIR (April 21, 1982), and we do so again in the context of this proceeding. Simply stated, the Commission does not believe that forward-looking, incremental cost studies form an appropriate basis for allocating revenue responsibility or designing rates for non-competitive, monopoly telephone services.

OCC witness Fish also argues that the Company's EDA should not be used as a basis for establishing rates (OCC Ex. 6, p. 21). That contention is based on the fact that the EDA failed to allocate common costs, such as executive salaries, and the fact that it failed to consider the Company's joint costs (*Id.*, at 21-23). Alarm Intervenors witness Edwards claims that the Company's EDA overstates the cost of private line services (Alarm Intervenors Ex. 1, p. 27). In addition, the EDA appears to be somewhat dated, since it was based on costs incurred during 1980 (Tr. VI, pp. 24-25). It is unnecessary, however, to address these issues in detail, because none of the parties have expressly advocated using the EDA for the purpose of allocating revenue responsibility.

The Staff, in conjunction with the National Regulatory Research Institute, performed a fully distributed, embedded cost of service study for purposes of this proceeding (Staff Ex. 1, p. 36; Staff Ex. 5, pp. 11, 20; Staff Ex. 10). A fully distributed cost study, unlike an embedded direct analysis, assigns common costs (or overheads) to the various individual service categories (Tr. VI, p. 15; Tr. XI, p. 2). The study basically allocated the Company's current costs among the following nine categories: Local Loop, Switch Network, Premise Wiring, State Private Line, Centrex, Terminal Equipment, Interstate Private Line, Toll, and Coin (Staff Ex. 1, p. 37).

The study offered four alternative methods for allocating non-traffic sensitive (NTS) costs (Staff Ex. 10, Chap-

ter 2, p. 4). The purpose of those factors is simply to recognize that a portion of the local loop and switch network costs should be allocated to the toll category (Tr. XI, pp. 9-10). In making the allocation, the Staff selected the subscriber line usage (SLU) factor (Tr. XI, p. 52). OCC suggests that the Staff should have used the subscriber plant factor (SPF), which is used by the Company in the separations process. There are clearly arguments for and against using either of the factors. However, in view of our ultimate conclusions concerning the allocation of revenue responsibility, discussed *infra*, there is no need to resolve this issue at the present time.

In general, the Commission believes that the Staff's cost study is sound and represents an appropriate starting point for determining revenue responsibility. TSTA witness Montgomery, however, has identified certain alleged deficiencies in the study concerning the allocation of costs to the State Private Line category (TSTA Ex. 1, pp. 17-29). Those issues are discussed under *Private Lines and Private Line-Like Services, infra.*

Call Screening Service

The Company proposes the establishment of a new call screening service, which would enable customers to restrict outgoing calls to collect, credit card, and third-number calls (Staff Ex. 1, p. 51). The service would be available only at locations where the facilities permit it, such as hotels, hospitals, and universities (*Ibid.*). The Company proposes a charge of $500.00 to establish the service, an initial charge of $5.00, and a monthly recurring charge of $6.00 per trunk line (*Ibid.*). None of the parties have expressed any objection, and the Commission believes that the Company's proposal should be approved.

Unrecovered Station Sets

The Company requests authority to impose a charge for station sets which are not recovered upon total or partial disconnection of service furnished to residence customers, or to non-residence customers with non-complex service, in the event that (1) the customer agrees to return the sets but fails to do so, (2) the customer makes a definite appointment for the Company to recover the sets and the Company meets the appointment, but finds that the sets are missing or is not given access to the premises, (3) the customer refuses to make a definite appointment for the Company to recover the sets, or (4) the customer has been disconnected for nonpayment and does not make an appointment for the Company to recover the sets or make other recovery arrangements (Co. Ex. 11, pp. 12-13). Station set losses are a growing concern for the Company; in 1981 alone, it failed to recover more than 29,400 sets (*Id.*, at 13). The purpose of this charge is to encourage customer cooperation in returning station sets, and to the extent that it fails to accomplish that goal, to recover the costs of unrecovered sets from those responsible without burdening the general body of ratepayers (*Ibid.*). The proposed charges, which are based on recent cost studies performed by the Company, are intended to recover the additional costs which the Company incurs as a result of unrecovered station sets (Staff Ex. 1, p. 50). The Staff supports the Company's proposal and none of the parties have expressed any objection. The Commission finds that the proposal is reasonable and should be approved.

Directory Assistance Calls

The Company proposes to increase the rate for directory assistance calls from $.20 to $.30 per call, on the grounds that the cost of providing the service has in-

creased (Staff Ex. 1, p. 43). The Company also proposes to increase the rate from $.40 to $.55 per call in instances where the call is placed through an operator (*Id.*, at 43, as corrected in Staff Ex. 5, p. 4). No change is proposed in the current allowance of free directory assistance calls (Staff Ex. 1, p. 43). The Staff recommends approval of these increases, and none of the parties have expressed any objection. The proposed increases should therefore be approved.

Local Coin Message Charge

None of the parties have recommended an increase in the Company's current $.25 local coin message charge. The Company has, however, proposed an increase from $.40 to $.50 in the coin message charge which applies to operator-handled calls (Staff Ex. 1, p. 43). The purpose of that increase is to maintain the same differential between operator-handled and non-operator handled calls which exists in the directory assistance area (*Ibid.*). The Staff recommends approval, and the Commission finds that the proposed increases are reasonable and should be approved.

Local Conference Service

The Company proposes to increase and restructure the rates applicable to local conference service (Co. Ex. 11, pp. 13-14; Staff Ex. 1, pp. 54-55). Specifically, the Company proposes to include the originating access line in calculating the charge, in order to achieve consistency with the method of charging for toll conference calls (Staff Ex. 1, p. 55). The Company also proposes to increase the charge for each additional minute from $.08 to $.09 in order to achieve consistency with the Ohio Bell toll schedule, in which it concurs (*Ibid.*). The Staff recommends approval of these changes, and the Commission agrees that they are reasonable and should be approved.

Operator Service Charge

The Company proposes to establish a charge which would apply in instances where a local operator is asked to verify that a line is in use, or to interrupt a conversation in progress (Co. Ex. 11, p. 16; Staff Ex. 1, p. 49). The charge would be $.50 for verification and $1.00 for interruption, except that only the $1.00 charge would apply if both functions are performed (Staff Ex. 1, pp. 49-50). The rationale for the proposed charges is that requests for verification or interruption create an expense for the Company which should not be borne by the general body of ratepayers (Co. Ex. 11, p. 16). The Staff generally supports the Company's proposals, but argues that the charges should not apply to emergency requests or instances involving line trouble (Staff Ex. 1, p. 50). The Commission believes that the Staff's recommendations are reasonable and should be adopted.

Fire-Retardant and Flat Under-Carpet Cable

The Company has proposed some rather substantial increases in the charges for fire-retardant and flat under-carpet cable (Staff Ex. 1, p. 55). For example, the initial charge for four-pair or twenty-five pair retardant cables would increase from $11.95 to $31.00, while the initial charge for flat under-carpet cable would rise from $14.00 to $110.00 (*Ibid.*). The Company's rationale for these increases is that these are premium items whose rates should be maximized for purposes of contribution (*Ibid.*). The Staff recommended approval of the proposed charges, but was not familiar with the costs of providing this equipment. (*Ibid.*).

The City of Cincinnati objected to the Staff's recommended approval of these charges, but failed to pursue the matter in testimony or on brief, and none of the other

parties have expressed any objection. Under these circumstances, the Commission would ordinarily approve the Company's proposal. However, in view of the magnitude of the Company's proposed increases and the lack of available cost data, the Commission believes that the most reasonable course of action would be to limit the increases in this area to the same average percentage increase assigned to the Basic Exchange category (net of curtailment).

Dimension P.B.X. Services

Cincinnati Bell proposes to discontinue offering Dimension Private Branch Exchange Service to new customers under its Two-Tier and Companion Payment Plans, as of a date to be established by the Commission (Co. Ex. 17, Sched. E-3, p. 35; Staff Ex. 1, pp. 52-53). Current customers would be permitted to continue using those plans, and new customers could obtain this equipment under the Variable Term Payment Plan (Staff Ex. 1, pp. 52-53). None of the parties have objected, and the Commission is of the opinion that the Company's proposed change is reasonable, and should be approved as of the effective date of the new tariffs resulting from this Opinion and Order.

Discontinuance of Certain Equipment

The Company proposes to withdraw Three-Line and Six-Line Double Key Boxes and Type C ACD-ESS customer premise equipment, due to a lack of customer demand and the fact that the equipment is no longer being manufactured (Co. Ex. 17, Sched. E-3, p. 16, 36; Staff Ex. 1, p. 53). There are no customers presently using this equipment (*Ibid.*), and none of the parties have expressed any objection. The Company's request should therefore be granted, and the Company should be authorized to discontinue offering this equipment as of the effective date of the new tariffs resulting from this Opinion and Order.

Operating Components of Decorator Telephones

Cincinnati Bell has proposed a $.25 increase in the rates for both Touch-Tone and rotary operating components of decorator telephones (Co. Sched. E-3, p. 15A; Staff Ex. 1, p. 56). None of the parties have expressed any objection, and the Commission is of the opinion that these increases are reasonable and should be approved.

Wire Tap Investigations

The Company proposes to establish a charge for performing wire tap investigations in instances where no wire taps or trouble conditions are found (Co. Ex. 11, p. 12; Staff Ex. 1, p. 50). The charge would be based on the costs incurred for the time spent on the investigation (Co. Ex. 11, p. 12). In 1980 and 1981, the Company received 166 requests to investigate possible wire taps (*Ibid.*). Those investigations revealed only seven instances of trouble in the Company's equipment or facilities and only one wire tap (*Ibid.*). As a result, the Company has concluded that its general body of ratepayers is being unfairly burdened with this expense (*Ibid.*).

The Staff recommends approval of the proposed charge, primarily to provide for recovery of the costs incurred in the investigation, but also to provide a deterrent to customers who might utilize the service unnecessarily (Staff Ex. 1, p. 50). The Commission finds that the Company's proposal is reasonable and should be adopted.

Non-Published and Non-Address Listings

The Company proposes no increase in the monthly rates for non-published and non-address listings, but seeks to increase the non-recurring charge for these services from $8.00 to $10.00 (Staff Ex. 1, p. 54; Staff Ex. 5, p.

15). The Staff found this increase to be reasonable (Staff Ex. 5, p. 15) and the Commission finds that it should be approved.

Custom Calling and Touch Tone Services

The Company proposes varying increases for its Custom Calling and Touch Tone Services (Co. Ex. 17, Sched. E-3, pp. 14-15). The monthly charge for residential call forwarding, for example, would increase from $2.50 to $2.75, while the monthly charges for residential Touch Tone service would rise from $.90 to $1.00 (Co. Ex. 16, Part 2, pp. 96, 99; Co. Ex. 15, Part 2, pp. 100, 103). The Company claims that these rates would exceed costs and would bear a reasonable relationship to rates for these services prevailing elsewhere in the United States (Co. Ex. 17, Sched. E-3, pp. 14-15). The Staff reviewed the Company's proposed increases and found them to be reasonable (Staff Ex. 1, p. 42), and none of the parties have expressed any objection. The proposed increases should therefore be approved.

Minimum Level Pricing

In *Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR (May 19, 1981), the Commission authorized the Company to apply minimum level, or flexible, pricing to various terminal equipment offerings. Under the existing flexible pricing tariff, the Company is free to establish the charge for such items anywhere between the minimum and maximum price levels. The maximum limit is currently equal to twice the minimum.

In this case, the Company requests authority to apply minimum level pricing to the following additional items: (1) Centralized Station Message Detail Recording, (2) Code-Com, (3) Four-Wire Service Terminating Arrange-

ment, (4) 42A Modular Converter, (5) Mobile Telephone Pocket Receiver, (6) Portable Communications Terminal, and (7) Portable Conference Set (Co. Ex. 11, p. 17; Staff Ex. 1, p. 49). The Staff has identified these items as customer premise equipment, and believes that the application of minimum level pricing would be appropriate (Staff Ex. 1, p. 49). None of the parties have objected to this proposal, and the Commission believes that it is reasonable and should be approved.

The Company also seeks authority to remove the maximum price level set forth in its flexible pricing tariff (Co. Ex. 11, pp. 15-16). Company witness Floyd argues that the maximum is unduly restrictive and unnecessary in view of the competitive nature of the items involved (*Id.*, at 16). The Staff and OCC both oppose removal of the maximum price (Staff Ex. 1, pp. 48-49; OCC Ex. 6, p. 32).

The Commission considered and rejected a similar proposal in *Ohio Bell Tele. Co.*, Case No. 81-436-TP-AIR (April 21, 1982), and the Company has presented no testimony or arguments which persuade us that a different result is appropriate here. Simply stated, flexible pricing is still a fairly recent innovation, and we believe that some measure of Commission control should be retained. If the Company believes that certain items should be priced at a level higher than the current maximum, it should concentrate its efforts on increasing both the minimum and maximum price levels, and not on attempting to eliminate the maximum entirely. *Ohio Bell Tele. Co., supra*, at p. 53.

Finally, OCC argues that the Commission should require the Company to enter into the same stipulation it entered into in its last rate proceeding, so that any excess

earnings resulting from its flexible pricing tariff are flowed back to the customers of its monopoly services. The Commission agrees, and will require the Company to file such an agreement when it submits its new tariffs in this proceeding. The failure to do so will result in the suspension of the flexible pricing tariff. *See Ohio Bell Tele. Co., supra,* at p. 54.

Terminal Equipment

On March 1, 1982, the Company implemented a number of price increases for terminal equipment offerings under its flexible pricing tariff, which were designed to increase revenues by approximately $10.6 million after curtailment (Co. Ex. 11, p. 22). The Company proposes no further rate increases for terminal equipment in this proceeding (*Ibid.*). The Staff similarly proposes no increases in terminal equipment prices (Staff Ex. 5, pp. 22-23). The Staff's cost study, however, indicates that the Company's terminal equipment revenues are significantly less than the cost of providing the equipment (Staff Ex. 1, p. 37). Specifically, terminal equipment provided only 17.90 percent of the Company's current revenue and would provide only 18.76 percent of the Company's proposed revenue, while such equipment is responsible for 20.40 percent of the Company's overall costs (*Ibid.*). That produces a revenue deficiency under the current rates of approximately $7 million (Tr. X, p. 120). As a result, both OCC and TSTA contend that the terminal equipment category should bear some portion of any rate increase to be approved in this proceeding. OCC witness Fish specifically recommends that the minimum rates on flexibly priced items be increased by 16.49 percent (the overall percentage increase requested by the Company), which he claims would produce a total revenue increase of $10,767,050 (OCC Ex. 6, p. 35).

The Company opposes any further increase in terminal equipment prices, but its arguments on this point are largely unconvincing. Initially, the Company claims that the Commission may not increase rates for any service for which the Company did not propose an increase, citing *Cleveland Electric Illuminating Co. v. Public Util. Comm.*, 42 Ohio St. 2d 403 (1975). That contention is without merit. Nothing in *Cleveland Electric Illuminating Co., supra*, bars the Commission from examining all of a utility's jurisdictional rates in a general rate proceeding in order to assure that some classes are not being required to cross-subsidize others.

The Company also notes that the results of any cost study are necessarily somewhat imprecise. That argument might be persuasive in instances where the indicated revenue deficiency is not substantial, but here, the Staff's cost study indicates that terminal equipment revenues are covering only 88 percent of the cost of providing the equipment (Staff Ex. 5, pp. 14, 22). Furthermore, the Company has not identified any deficiencies in the Staff's cost study as it relates to the terminal equipment category.

The record clearly indicates that present terminal equipment revenues are not covering the associated cost. The Commission believes that immediate steps should be taken to eliminate this revenue deficiency, so that the Company's monopoly service customers are not required to subsidize competitive terminal equipment offerings. However, the principles of rate continuity and gradualism suggest that the entire deficiency need not be eliminated at one time. The Commission faced a similar situation in *Ohio Bell Tele. Co.*, Case No. 81-436-TP-AIR (April 21, 1981). There, we required the applicant to eliminate 25 percent of the deficiency in terminal equipment revenues,

and we believe that a similar result is appropriate here. Furthermore, we believe that the increased revenue requirement resulting from the adoption of remaining life depreciation rates for the terminal equipment accounts should also be assigned to that category. Therefore, we will require that the increased revenue requirement ($2,757,000) plus 25 percent of the deficiency existing under current revenues should be allocated to the terminal equipment category for purposes of this proceeding. The Commission will give the Company the initial discretion to make the necessary rate changes under its flexible pricing tariff. If the Company deems it appropriate to increase the prices for individual items beyond the existing maximum price levels, the Commission will allow the Company to increase the minimum prices for those items up to 25 percent. (The maximum price levels will remain at twice the minimum.) The Commission will require the Company to file a statement within thirty days of the date of this Opinion and Order, explaining how it adjusted rates for terminal equipment.

Private Lines and Private Line-Like Services

Private line service is a communications service furnished between specified locations. It includes private line telephone and teletypewriter services, as well as channels, or electrical paths, which are used for signalling, telemetering, the operation of burglar alarm systems, program transmission, and data transmission (Co. Ex. 11, p. 18). The Company proposes widely varying increases for these services in this proceeding. For example, it proposes to increase the monthly rate for two local Type 901 Channels (Alarm Circuits) using the same central office from $16.40 to $38.00, and to increase the rate for two local Type 2001 Channels (Voice Grade Private Line) using the same central office from $16.60 to $50.40 (Staff Ex.

1, p. 47). The proposed increases in private line rates are opposed by TSTA and the Alarm Intervenors.

There are two fundamental questions to be resolved in this area. The first involves the determination of the total amount of revenue responsibility to be assigned to the private line category. As noted previously, the Company's prospective resource cost studies do not provide an appropriate basis for making that determination. The Staff's cost study indicates that an increase in private line rates would be justified (Staff Ex. 1, p. 37). TSTA witness Montgomery, however, argues that the Staff's study contains certain errors which result in an overallocation of costs to the private line category (TSTA Ex. 1, pp. 17-29).

Mr. Montgomery has presented two principal criticisms in that regard. The first involves the allocation of outside plant. Specifically, he argues that the Staff's study failed to consider the fact that private line loops are shorter and less expensive than the loops attributable to the remainder of the Company's services (*Id.*, at 18). Staff witness Mount-Campbell, however, testified that the Staff's study did utilize the shorter "deaveraged" loop lengths in determining private line costs (Tr. XI, pp. 18, 41-44). On the basis of the evidence in the record, we are not convinced that the Staff has overallocated outside plant to the private line category.

Mr. Montgomery also claims that the Staff has improperly allocated a large amount of switching equipment to the private line category (TSTA Ex. 1, pp. 18-19). Private lines, by definition, are not switched (Tr. XI, p. 17), and Mr. Montgomery argues that none of the Company's switching equipment should be allocated that category (*Id.*, at 18). Although Staff witness Mount-Campbell presented extensive testimony describing the manner in which the cost allocations were made (Tr. XI, pp. 19-41),

there is no evidence in the record which expressly refutes Mr. Montgomery's assertions on this issue. Consequently, the Commission is of the opinion that the Staff's cost study should not be used to determine the overall revenue responsibility for the private line category, until the Staff has had an opportunity to review the manner in which the cost of switching equipment is allocated to that category, and to determine whether a change in the allocation methodology would be appropriate.

The Commission is not, however, convinced that no increase should be assigned to the private line category. Although the Alarm Intervenors have made that argument, their position lacks credibility because they have applied the private line category's percentage share of the Company's *total* costs (as determined by the Staff's cost study) to the Company's *intrastate* revenue requirements.

The question, then, is how the total revenue responsibility for the private line category should be determined. The Commission faced a somewhat similar situation in *Ohio Bell Tele. Co.*, Case No. 81-1433-TP-ATA (December 22, 1982), and concluded that the intrastate private line category should bear the same percentage increase (on a curtailed basis) as the basic exchange category. We find that a similar approach should be adopted for purposes of this proceeding.

The second issue in this area involves the determination of specific rates for individual private line services. Once again, it should be noted that the Company's prospective cost studies fail to provide an appropriate basis for that determination. Nor does the Staff's study offer assistance in this area, since it is based on overall costs for aggregate categories, and provides no cost data for individual services within the private line category (Tr. X, pp. 125-126; 130-132). In short, the record fails to justify the adoption of

varying increases for different private line services. The Commission therefore finds that the rates for all intrastate private lines and private line-like services should be increased on an across-the-board, average percentage basis.

Facilities for Other Common Carriers

The Company proposes to increase and restructure the rates applicable to facilities provided to other common carriers, in order to make those rates consistent with similar offerings in its Private Line Tariff (Co. Ex. 11, pp. 22-23; Staff Ex. 1, p. 48). Although those services have been provided to other carriers, such as Western Union, in the past, there are presently no customers who would be affected by this proposal (Staff Ex. 1, p. 48). The Commission is of the opinion that the rates for this category should be increased by the same average percentage increase applicable to private lines and private line-like services.

Telephone Answering Services

Telephone Answering Services use concentrator-identifier systems, which are capable of transferring calls from up to 100 subscriber lines, through the telephone company's central office, to the offices of the answering service where they are answered by one of its operators (Answering Exchange Ex. 1, p. 4). The Company proposes to restructure the rates for concentrator-identifiers, and to increase those rates by an overall average of 33.5 percent (Co. Ex. 17, Sched. E-3, p. 10; Staff Ex. 1, p. 51). The Staff recommends an overall increase of 16.7 percent (Staff Ex. 5, p. 16). Answering Exchange, which currently uses a number of concentrator-identifiers, argues that the rates for this service should be increased by no more than the overall percentage increase approved in this proceeding.

It is something of an understatement to say that the Company's proposed restructuring would result in widely varying increases in concentrator-identifier rates, depending upon the total number of lines which are served. The proposed increases would range from a negative amount to more than 250 percent (Staff Ex. 1, p. 52; Tr. XVII, pp. 12-14). Specifically, the rate for a concentrator-identifier serving zero to 50 lines would increase by 17.2 percent, the rate for 51 to 60 lines would increase by 252 percent, and the rate for 61 to 80 lines would increase by 101 percent (Tr. XVII, pp. 12-14). An answering service with a concentrator-identifier serving 81 to 100 lines would pay no charge for that equipment under the proposed rates (Tr. VII, p. 23). In support of the proposed restructuring, Company witness Floyd argues that the cost of providing concentrator-identifiers does not vary with the number of lines which are connected, and that the proposed rates represent an attempt to produce the same amount of revenue from various concentrator-identifiers, at least at periodic points along the scale (*Id.*, at 28-29).

At first glance, it might seem that the most logical solution would be to charge a flat rate for each concentrator-identifier, irrespective of the number of lines which are connected. The situation is complicated, however, by the fact that each of the answering service's customers pays the Company a bridging connection charge, which is not dependent upon the total number of lines connected. Consequently, a flat rate would produce comparatively little revenue from a concentrator-identifier serving ten lines, while producing considerably more revenue from a system serving one hundred lines (*See generally* Tr. VII, pp. 35-37).

It is undoubtedly true that the proposed restructuring would stabilize revenues at periodic points along the scale.

For concentrator-identifiers serving 35, 55, 70, or 90 lines, the Company would receive exactly $409.50 per month in total revenues (Tr. XVII, pp. 16-18). It is not clear, however, that the proposed restructuring would significantly contribute toward stabilizing the revenues produced by different concentrator-identifier systems on an overall basis. On brief, Answering Exchange presented figures indicating that the range of possible charges for concentrator-identifier systems would actually *increase* under the proposed rate structure. The Company has not challenged those figures. Instead, the Company has countered with figures specifically applicable to Answering Exchange's concentrator-identifiers, which indicate that the range of charges for those systems would fall from $150.50 to $72.80. That obviously represents a reduction, but the range remains substantial.

The Commission is cognizant of the difficulty of creating cost-based rates in this area, but we are not persuaded, on the basis of the record, that the Company's proposed restructuring is reasonable. Even if we were, the principles of rate continuity and gradualism would dictate that increases of the magnitude proposed by the Company should not be approved at one time, in the absence of compelling circumstances. It is nonetheless clear that concentrator-identifiers should be assigned some portion of the rate increase in this case, since Company witness Floyd testified that the proposed rates would not fully recover the cost of providing these services, even on an embedded cost basis (Tr. VII, p. 25). Under these circumstances, the Commission believes that the most reasonable approach is to increase the rates for concentrator-identifier systems, including the applicable bridging connection charges, by the same average percentage applicable to private lines and private line-like services, discussed *supra*.

Direct Inward Dialing

Cincinnati Bell proposes to increase the rates for Direct Inward Dialing from $200 to $260 for the initial block of one hundred numbers, and from $40 to $52 for each additional block (Tr. VII, pp. 58-60). No cost studies were performed for this service; the proposed increases were based on the standard 30 percent figure, which was based on the Company's requested overall increase in intrastate rates, exclusive of toll revenues and revenues from items subject to minimum level pricing (*Id.*, at 60; Co. Ex. 11, p. 6).

Answering Exchange opposes the proposed increase, on the grounds that the Company has failed to provide cost justification, and because a similar service is provided under an FCC radio common carrier tariff for $18.75 (Tr. VII, p. 60). Since the Company's proposed rates were based on the standard 30 percent increase, and the Commission has approved an overall increase which is substantially less than that, the Commission is of the opinion that the increase for Direct Inward Dialing should also be limited to the same average percentage applicable to private lines and private line-like services.

Non-Recurring and Premise Work Charges

In *Cincinnati Bell Inc.*, Case No. 80-476-TP-AIR (May 19, 1981), the Commission authorized the Company to implement time sensitive charges for premise work done for non-complex residence customers. Under this plan, the charges for most billable premises work required to install, rearrange, or reconnect service depend upon the amount of time required to perform the work (Staff Ex. 1, p. 41). The Staff argues that this plan is easy for the customers to understand, and allows them to exercise more control over the charges incurred (*Ibid.*).

In this proceeding, Cincinnati Bell proposes to extend this plan to customers with non-complex business service, and to increase the charges for billable premise work. The Company also proposes to add definitions of complex and non-complex service to its tariffs (Staff Ex. 1, pp. 41-42, 52). The Staff recommends approval of these charges (*Ibid.*), and none of the parties have objected. The Commission believes that these proposals are reasonable and should be adopted.

The Company has also proposed widely varying increases in the non-recurring or service connection charges for various services (Staff Ex. 1, p. 41). The overall increases would amount to 20.6 percent for Account 500, 69.2 percent for Account 504, and 112.3 percent for Account 512 (*Ibid.*). The non-recurring charge for intra-exchange voice grade 2001 private lines, for example, would rise from $70 to $205, while the charge for a type 3002 channel would increase from $80 to $245 (TSTA Ex. 1, p. 45). The Company's proposals in this area have engendered considerable opposition from the Alarm Intervenors, TSTA, and Answering Exchange.

The intervenors' principal criticism is that the proposed charges fail to fully reflect certain technological developments which should reduce the cost of line connection, testing, and other functions (*See generally* Alarm Intervenors Ex. 1, pp. 20-26; TSTA Ex. 1, pp. 45-46). As an example of such developments, the intervenors cite the Switched Maintenance Access System (SMAS), augmented by a Special Access Remote Testing System (SARTS), which reduces both time and personnel requirements by enabling one individual to perform various testing functions from a single location (Alarm Intervenors Ex. 1, pp. 24-26; TSTA Ex. 1, pp. 52-53). The parties appear to agree that non-recurring charges should be based upon

the current cost of providing the service, but the intervenors argue that the Company's proposed charges overstate those costs.

Although there was extensive testimony on this issue, the intervenors' principal assertions remain essentially unrefuted. Only recently, in *Ohio Bell Tele. Co.*, Case No. 81-1433-TP-AIR (December 22, 1982) at p. 64, we recognized that service connection charges should be based on state of the art technology. It does not appear that the Company's proposed charges have adequately taken such factors into account. Therefore, with the exception of the specific non-recurring charges approved elsewhere in this opinion and order, the Commission finds that the increases in service connection and other non-recurring charges should also be limited to the average percentage increase applicable to private lines and private line-like services (net of curtailment). In no instance, however, should such charges be increased beyond the level originally proposed by the Company.

Optional Measured Rate Service

In *Cincinnati Bell Inc.*, Case No. 81-1317-TP-ATA (March 24, 1982), the Commission authorized the Company to implement four-dimensional Optional Measured Rate Service. The charges for that service depend upon the number of calls made, the length of the calls, the distance which the calls travel, and the time at which the calls are made (Tr. VI, p. 37). The Company began offering the service in some areas on September 20, 1982 (Tr. IX, p. 117).

The Company proposes no increase for Optional Measured Rate Service in this case. OCC witness Fish argues that the Company's proposal is discriminatory, because it will result in flat rate customers paying a higher access

charge than measured rate customers, and recommends that the rates for Optional Measured Rate Service be increased by the same percentage as other basic services (OCC Ex. 6, pp. 27-29). The City of Cincinnati, citing certain alleged deficiencies in the Company's original application in Case No. 81-1317-TP-ATA and the review process which led to its approval by the Commission, argues that Optional Measured Rate Service should be withdrawn.

The City's argument, in our opinion, overlooks two essential considerations. In the first place, the service is *optional;* it increases the customers' choices by providing an alternative type of basic exchange service (Tr. IX, p. 114). Second, and perhaps more importantly, it provides customers with certain usage characteristics, the opportunity to lower their telephone costs by controlling their usage (*Ibid.*). These factors alone, in our judgment, justify the retention of Optional Measured Rate Service. The City's arguments should therefore be rejected.

OCC's contention, on the other hand, would ordinarily be persuasive, and under normal circumstances, we would probably approve some increase in the rates for Optional Measured Rate Service. In this case, however, we are dealing with a fairly innovative service which has only recently been implemented. There has obviously been insufficient time to collect and analyze detailed data concerning the number of customers selecting the optional service, their usage characteristics, the level of investment actually required to furnish the service, and other pertinent factors (Tr. IX, p. 114-115). The Staff has indicated that it will examine such factors when empirical data becomes available (*Id.*, at 115-116, 118-119a; Staff Ex. 8, p. 6).

In addition, Company witness Sigmon expressed the opinion that the usage sensitive portion of the optional

measured rate was currently covering the associated costs (Tr. VI, pp. 34-35). Although he doubted that the access line portion was currently covering its cost (*Ibid.*), that fact should not make the present rates objectionable, because basic exchange services have traditionally been considered benefitted services which are priced somewhat below their actual cost (*See* OCC Ex. 6, p. 17). The record, moreover, does not establish that any difference between the access line charges in the Flat Rate and Optional Measured Rate Tariffs is of sufficient magnitude as to be either unreasonable or unjustly discriminatory. In short, the Commission is not persuaded that the rates for Optional Measured Rate Service should be increased at the present time. OCC's arguments should therefore be rejected.

Basic Exchange

Cincinnati Bell proposes to increase the rate for additional local messages from $.11 to $.14 (Co. Ex. 17, Sched. E-3, p. 18). That proposal was based on the standard 30 percent increase, which was derived from the Company's overall requested increase in intrastate revenues, less toll revenues and revenues attributable to items subject to minimum level pricing (*Ibid.*; Co. Ex. 11, p. 6). Since the overall increase approved in this proceeding is substantially less than that amount, the Commission is of the opinion that the charge for additional local messages should only be increased to $.12 per message.

The Company proposes to residually price the balance of its basic exchange services (Co. Ex. 11, p. 6). The Commission agrees that that would be appropriate, and directs the Company to apply the same average percentage increase to the remainder of its basic exchange services, with the caveat that the overall percentage increase

assigned to this category should be the same as that assigned to private lines and private line-like services (net of curtailment), concentrator-identifiers, Direct Inward Dialing, non-recurring and service connection charges (net of curtailment), and flat under-carpet and fire-retardant cable (net of curtailment), discussed *supra*. The Commission also notes that the Basic Exchange category should encompass all main related items, including Combination Main Telephone Service, Joint Users Service, Long Distance and Toll Terminals, Announcement Lines, Centrex Services, ESSX-1 Network Access Registers, Interconnecting Facilities, Information System Access Lines, and Mobile Wire Lines (Co. Sched. E-3, p. 1A; Staff Ex. 1, pp. 55-56).

Mobile Telephone Service

The Company proposes to increase the message charge for mobile telephone service to $.14 per message (Staff Ex. 1, p. 44). The Staff supports an increase in this charge, but argues that its magnitude should depend upon the increase approved for the local message charge under the Exchange Rate Tariff (*Ibid.*). Since we have already approved a $.12 charge under that particular tariff, we will approve a similar charge for the Company's mobile telephone service.

Other Services

TSTA, the Alarm Intervenors, and OCC suggest that a portion of the revenue increase to be approved in this case should be assigned to other jurisdictional services for which the Company has not proposed an increase. We have already decided that a portion of the increase should be assigned to the terminal equipment category. An increase in intrastate toll rates would not be appropriate,

because the Company concurs in the message toll tariffs of Ohio Bell Telephone Company. After carefully reviewing the record in this case, we are not persuaded that the rates for any other jurisdictional services should be increased at the present time.

Pole Attachment Tariffs

Section 4905.71, Revised Code, requires the Commission to regulate the charges, terms, and conditions for the attachment of cable television or other wires or facilities to utility poles. The Commission originally intended to consider such questions in a generic proceeding (Case No. 81-1109-AU-ORD), but later concluded that these matters could be more expeditiously handled on a case by case basis in individual rate proceedings.

The Company argues that the Commission lacks jurisdiction to consider its pole attachment charges in this proceeding. That contention is without merit. Section 4905.71 expressly authorizes the Commission to investigate such matters on its own initiative, and to conduct hearings in order to establish just and reasonable charges, terms and conditions. There is no reason why that authority cannot be exercised in the context of a general rate proceeding.

Although the parties have presented extensive testimony concerning the proper methodology to be used in establishing pole attachment rates (*See, e.g.,* OCTVA Ex. 1, 1a, and 2; Co. Ex. 10a and 11a; Staff Ex. 12 and 12a), there is no need to discuss this testimony in detail, because the Commission has decided to adopt the formula used by the Federal Communications Commission (FCC) in setting such rates. *Ohio Bell Tele. Co.,* Case No. 81-1433-TP-AIR (December 22, 1982) at p. 71; *Columbus & Southern Ohio Electric Co.,* Case No. 81-1058-EL-AIR

(November 5, 1982) at p. 46. The Commission has adopted that methodology in an effort to establish an approach which can be uniformly applied in all cases, thereby simplifying the process of determining the charges without sacrificing the reasonableness of the result.

The Commission therefore adopts the FCC methodology for purposes of determining appropriate pole attachment charges in this proceeding. The Company is therefore directed to file proposed pole attachment charges computed on the basis of the FCC formula and the following specifications: 1 foot of space occupied by attachments, 13.5 feet of total usable pole space, a net pole cost adjusted by a factor of .85 for extraneous items, the Commission-approved rate of return, and the Commission-approved depreciation accrual rate converted to the net pole relationship. The Company should also submit a schedule setting forth the procedures and values used in this computation.

Other Issues

With respect to all rates and tariffs issues which are not specifically discussed in this opinion and order, the Commission finds that the Staff's positions are reasonable and should be adopted.

Bill Itemization

OCC argues that the Company should be required to itemize its customers' bills so that the customers can determine precisely how much they are paying for each individual service (*See* OCC Ex. 6, pp. 40-41). In support of this proposal, OCC claims that such information would aid the customers in making informed choices concerning the selection of competitive services. Although the Company has not specifically objected to OCC's proposal, the Com-

mission is not persuaded that it is either necessary or appropriate to require itemization of the customers' bills.

To begin with, the requested information is already available in the Company's tariffs and can easily be obtained by calling the business office (Tr. VII, p. 69). Furthermore, the requested itemization would obviously entail some cost to the Company, which would ultimately be borne by the Company's ratepayers (*Ibid.*). Finally, the Commission frankly sees no need to require the Company to furnish information which can and should be furnished through the marketing efforts of the Company's competitors. The Commission will, however, require the Company to include information in its rate increase notice indicating (1) that telephone sets provided by the Company are leased by the customer, (2) that the charge for such equipment is included on the monthly service and equipment line of the customer's telephone bill, and (3) the Company's current charges for such equipment.

Requests for Cost Studies or New Service Offerings

Answering Exchange requests that the Commission order Cincinnati Bell to prepare and present a cost study and proposed tariffs to implement a bulk cabling offering known as Customer Operating Center Service (COCS). According to Answering Exchange witness Hoskins and Alarm Intervenors witness Edwards, who also supports such an offering, this service recognizes the economics of scale in providing bulk cable service and includes pricing concepts based upon the distance between the customer and the central office (Alarm Intervenors Ex. 1, pp. 16-17; Answering Exchange Ex. 1, pp. 23-25). In *Ohio Bell Tele. Co.*, Case No. 81-1433-TP-AIR (December 22, 1982) at p. 70, we noted that COCS services are currently offered by certain other companies in the Bell System. Since Cin-

cinnati Bell did not oppose this recommendation, the Commission will require the Company to submit a proposed COCS tariff and supporting cost study in its next general rate proceeding. The Commission will decide at that time whether such a tariff should be implemented.

The Alarm Intervenors objected to the Staff's failure to recommend that the Company be directed to offer derived channel capability to its private line customers. On brief, they argue that the Company should be directed to file testimony in its next proceeding concerning the derived channel technology and its application in Ohio. The Company has not opposed this recommendation, and the Commission will direct the Company to provide such testimony in its next general rate proceeding.

Finally, Answering Exchange asks that the Commission order Cincinnati Bell to submit a cost study of Direct Inward Dialing (DID), based upon an AT&T model, in its next rate proceeding, or in the alternative, to set DID rates at the same level approved by the FCC for similar service provided under the radio common carrier tariff. The Commission agrees that such a cost study should be submitted, and will direct the Company to do so, but we do not believe it appropriate to designate the methodology to be employed. We will, however, expect the Company to justify the method it has chosen.

Effective Date:

Section 4909.42, Revised Code provides that if the Commission has not acted upon a rate application within 275 days after the application is filed, the applicant utility may, upon the filing of an undertaking in an amount determined by the Commission, place its proposed rates in effect, subject to the condition that any amounts collected

in excess of those finally determined to be reasonable by the Commission shall be refunded to the Company's customers. The Commission makes every effort to issue its rate orders within the 275 day period, in order to avoid the customer confusion which might result if the refund provision were invoked. Unfortunately, due to the length of the hearings and the number of complex issues in this case, it was not possible for the Commission to issue an Opinion and Order within the 275 day period. However, Cincinnati Bell has not attempted to place its proposed rates in effect, and the Commission believes that basic principles of fairness dictate that the Applicant should not be penalized for its forbearance. The Commission, therefore, finds that the appropriate course in this proceeding is to provide that the new tariffs shall take effect on the date they are accepted for filing by the Commission. The customary notice requirements will, of course, be retained, and such notice should be mailed to the affected customers upon approval of its form by the Commission.

FINDINGS OF FACT:

From the evidence of record in this proceeding, the Commission now makes the following findings:

1. The value of all of Applicant's property used and useful for the rendition of telephone service to the customers affected by this application, determined in accordance with Sections 4909.05 and 4909.15, Revised Code as of the date certain of February 28, 1982, is not less than $407,275,000.

2. For the twelve month period ending August 31, 1982, the test period in this proceeding, the revenues, expenses, and income available for fixed charges realized by Applicant under its present

rate schedules were $267,481,000, $228,162,000, and $39,319,000 respectively.

3. This net annual compensation of $39,319,000 represents a rate of return of 9.65 percent on the jurisdictional rate base of $407,275,000.

4. A rate of return of 9.65 percent is insufficient to provide Applicant reasonable compensation for the service rendered customers affected by the application.

5. A rate of return of 12.50 percent is fair and reasonable under the circumstances presented by this case and is sufficient to provide Applicant just compensation and return on the value of its property used and useful in furnishing telephone service to its subscribers.

6. A rate of return of 12.50 percent applied to the rate base of $407,275,000 will result in income available for fixed charges in the amount of $50,909,000.

7. The allowable annual expenses of the Company for purposes of this proceeding are $238,989,000.

8. The allowable gross annual revenue to which the Applicant is entitled for purposes of this proceeding is the sum of the amounts stated in Findings 6 and 7, plus an allowance for uncollectibles of $1,086,000, or $290,984,000.

9. The Company's present tariffs governing service to customers should be withdrawn and cancelled and the Applicant should submit new tariffs consistent in all respects with the discussion and findings set forth above.

CONCLUSIONS OF LAW:

1. The application herein was filed pursuant to and this Commission has jurisdiction thereof, under the provisions of Sections 4909.17, 4909.18 and 4909.19 Revised Code; further, the Applicant has complied with the requirements of those statutes.

2. A staff investigation was conducted and a report duly filed and mailed, and public hearings have been held herein, the written notice of which complied with the requirements of Section 4909.19 Revised Code.

3. The existing rates and charges as set forth in the tariffs governing telephone service to customers affected by this application are insufficient to provide the Applicant with adequate net annual compensation and return on its property used and useful in the rendition of telephone service.

4. A rate of return of 12.50 percent is fair and reasonable under the circumstances of this case and is sufficient to provide the Company just compensation and return on its property used and useful in the rendition of telephone service to its customers.

5. The Company should be authorized to cancel and withdraw its present tariffs governing service to customers affected by this application and to file tariffs consistent in all respects with the discussion and findings set forth above.

ORDER:

It is, therefore,

ORDERED, That the application of Cincinnati Bell Inc. for authority to increase its rates and charges for telephone service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That the Company be authorized to cancel and withdraw its present tariffs governing service to customers affected by this application and to file new tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) complete copies of tariffs conforming to this Opinion and Order, the Commission will review and approve those tariffs by Entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are approved by Commission Entry. The new rates included therein shall be applicable to all service rendered on or after the effective date. It is, further,

ORDERED, That the Company shall immediately commence notification of its customers of the increase in rates authorized herein by insert or attachment to its billings, by special mailing, or by a combination of the above. The Company shall submit a proposed form of notice to the Commission when it files its tariffs for approval. The Commission will review the notice and, if it is proper, will approve it by Entry. It is, further,

ORDERED, That the depreciation rates approved herein be effective as of June 1, 1982. It is, further,

ORDERED, That the Applicant comply with all directives set forth in this Opinion and Order. It is, further,

ORDERED, That all objections and motions not specifically discussed in this Opinion and Order, or rendered moot thereby, be overruled and denied. It is, further,

ORDERED, That a copy of this Opinion and Order be served on all parties of record.

THE PUBLIC UTILITIES COMMISSION
OF OHIO
/s/ [Illegible]
Chairman
/s/ DENNIS PINES
/s/ MICHAEL DEL BANE
Commissioners

Entered in the Journal
Jan 7, 1983
A True Copy

/s/ DAVID M. POLK
DAVID M. POLK
Secretary

STATE OF OHIO
PUBLIC UTILITIES COMMISSION
375 South High Street
Columbus, Ohio 43215

January 7, 1983

In the last three telephone cases, we determined that whole life depreciation rates were appropriate. Case No. 81-1338-TPAIR incorporates remaining-life rates. To be consistent with my voting on such cases, I am casting a negative vote on Case No. 81-1339-TP-AIR.

/s/ MICHAEL DEL BANE
Commissioner

DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT IN VIRGINIA STATE CORPORATION COMMISSION v. FCC, ET AL.

(Entered: June 18, 1984)

No. 83-1136

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Virginia State Corporation Commission, — Petitioner,

v.

Federal Communications Commission and United States of America, — Respondent.

North American Telephone Association, — Intervenor./R,

American Telephone and Telegraph Company, — Intervenor./R,

Florida Public Service Commission, — Intervenor./P,

State of Michigan and Michigan Public Service Commission, — Intervenor./P,

Department of Public Utility Control of the State of Connecticut, — Intervenor./P,

People of the State of California and the Public Utilities Commission of the State of California,	Intervenor./P,
National Association of Regulatory Utility Commissioners,	Intervenor./P,
Southern Pacific Communications Company,	Intervenor./R,
Public Service Commission of the District of Columbia,	Intervenor./P,
Public Utilities Commission of Ohio,	Intervenor./P,
Arkansas Public Service Commission,	Intervenor./P,
Kansas State Corporation Commission,	Intervenor./P,
GTE Service Corporation,	Intervenor./R,
Public Service Commission of Wyoming,	Intervenor./P,
Continental Telecom Inc.,	Intervenor./R,
Washington Utilities and Transportation Commission,	Intervenor./P,

United Telephone System, Inc.,	Intervenor./R,
Department of Public Service of the State of Minnesota,	Intervenor./P,
Arizona Corporation Commission,	Intervenor./P,
Cincinnati Bell Inc.,	Intervenor./R,
Citizens of the State of Florida,	Intervenor./P,
National Association of State Utility Consumer Advocates,	Intervenor./P,
Consumer Advocate of South Carolina,	Intervenor./P,
Office of Consumers' Counsel for the State of Ohio,	Intervenor./P,
Iowa State Commerce Commission,	Intervenor./P,
Public Service Commission of Wisconsin,	Intervenor./P,
Public Service Commission of West Virginia,	Intervenor./P,
New York State Department of Public Service,	Intervenor./P,

The Bell Telephone Company of Pennsylvania,	Intervenor./R,
The Chesapeake and Potomac Telephone Company,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Maryland,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Virginia,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of West Virginia,	Intervenor./R,
The Diamond State Telephone Company,	Intervenor./R,
Illinois Bell Telephone Company,	Intervenor./R,
Indiana Bell Telephone Company, Incorporated,	Intervenor./R,
Michigan Bell Telephone Company,	Intervenor./R,
The Mountain States Telephone and Telegraph Company,	Intervenor./R,
New England Telephone and Telegraph Company,	Intervenor./R,
New Jersey Bell Telephone Company,	Intervenor./R,

New York Telephone Company, Intervenor./R,

Northwestern Bell Telephone Company, Intervenor./R,

The Ohio Bell Telephone Company, Intervenor./R,

Pacific Northwest Bell Telephone Company, Intervenor./R,

The Pacific Telephone and Telegraph Company, Intervenor./R,

Bell Telephone Company of Nevada, Intervenor./R,

South Central Bell Telephone Company, Intervenor./R,

Southern Bell Telephone and Telegraph Company, Intervenor./R,

The Southern New England Telephone Company, Intervenor./R,

Southwestern Bell Telephone Company, Intervenor./R,

Wisconsin Telephone Company, Intervenor./R,

Board of Public Utilities of New Jersey, Intervenor./R,

Louisiana Public Service Commission, Intervenor./R.

On Petition for Review from a Decision by the Federal Communications Commission.

Argued October 7, 1983
Decided June 18, 1984

Before WIDENER, MURNAGHAN, and SPROUSE, *Circuit Judges*.

Russell W. Cunningham (Donald G. Owens, Sherry H. Bridewell; David E. Blabey, Lawrence G. Malone; Lynwood J. Evans; Richard P. Rosenberry, Lawrence F. Barth; Lloyd N. Moore, Jr.; Donald A. Low, Rosemary O'Leary; Harris S. Leven, Jonathan L. Heller; Jean E. Heilman; Lee McCulloch; Jack Shreve, Benjamin H. Dickens, Jr.; Steven W. Hamm, Raymond E. Lark, Jr., Russell H. Putnam, Jr.; Joseph I. Lieberman, Peter J. Jenkelunas; Janice E. Kerr, Gretchen Dumas, J. Calvin Simpson; Douglas N. Owens; Steven R. Shanahan; Bruce W. Renard; Diane L. McIntire; Steven M. Schur, Jon E. Kingstad; Paul Rodgers, Charles D. Gray; Frank J. Kelley, John M. Dempsey; Joel B. Shifman on brief) for Petitioner; John E. Ingle, Deputy Associate General Counsel (Bruce E. Fein, General Counsel, Daniel M. Armstrong, Associate General Counsel on brief) for Respondents; Michael Boudin (Leonard R. Stein; Raymond F. Scully, Lester G. Stiel, W. Preston Granbery; Earl R. Huffman, David Horn; Thomas L. Jones, John Wohlstetter; Richard McKenna, James Hobson; Albert H. Kramer; John W. Hunter, Carolyn C. Hill; Maria A. Kendro on brief) for Intervenors Supporting Respondents.

MURNAGHAN, *Circuit Judge*:

The controversy here presented involves an order of the Federal Communications Commission (FCC) entitled

"Uniform System of Accounts and Petition for Declaratory Ruling on Question of Federal Preemption." CC Docket No. 79-105, FCC 82-581 (released Jan. 6, 1983). The order provides that, when the FCC has prescribed depreciation rates and methods for classes of property used by telephone companies, state regulation of the same matter is thereby preempted.

Petitioner, Virginia State Corporation Commission, along with multiple Petitioner-Intervenors representing regulatory agencies of other states, argues that the states' fixing of depreciation rates and accounting methods for intrastate ratemaking purposes is preempted neither by the express language of the Federal Communications Act of 1934, 47 U.S.C. § 151 *et seq.* (1976) (the Act), nor by FCC rules explicitly governing depreciation of telephone equipment and facilities that are used interchangeably to provide both interstate and intrastate service. We agree with the FCC that its order released January 6, 1983 preempts state regulation of the depreciation rates and methods here involved, and thereby reemphasize our recognition in *North Carolina Utilities Commission v. F.C.C.*, 552 F.2d 1036 (4th Cir. 1977) ("NCUC II"), *cert. denied*, 434 U.S. 874 (1977), that "FCC regulations must preempt any contrary state regulations where the efficiency . . . of the national communications network is at stake. . . ." *Id.* at 1046.

I. *Background*

Under the current state of the telecommunications art, local telephone companies provide "telephone plant" (facilities and equipment) that serve both interstate and intrastate communications needs. Section 152 of the Act provides in subsection (a) that the statute "shall apply to all interstate and foreign communication by wire,"

but in subsection (b) that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire . . . ." Within this framework of divided authority, the Commission's statutory mandate is a broad one, "to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and world-wide wire . . . communication service with adequate facilities at reasonable charges. . . ." 47 U.S.C. § 151.

In order to achieve the mandated goal, the FCC is specifically empowered under 47 U.S.C. § 220 to prescribe depreciation practices to be followed by interstate carriers.[1] At the same time, the Act recognizes the continued vitality of state regulation of intrastate service. Section 221(b) provides that "nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire . . .

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1. Section 220(b) provides that:

> The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property . . . . The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. . . .
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> (g) After the Commission has prescribed the forms and manner of keeping of accounts . . . it shall be unlawful for [the carrier] to keep any other accounts . . . than those so prescribed . . . or to keep accounts in any manner other than that prescribed or approved by the Commission. . . .

exchange service . . . even though a portion of such exchange service constitutes interstate . . . communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority." Because most of the nation's telephone plant is used interchangeably to serve both interstate and intrastate telecommunications needs, the potential for conflict between federal and state regulatory action is obvious.[2]

The conflict at issue on this appeal had its genesis in two separate orders issued by the FCC in 1980 and 1981; both orders were designed to compel carriers to employ depreciation practices that more truly reflected actual depreciation rates in light of technological reality. After seven years of study, the FCC first determined in 1980 that the prior practice of "vintage year" grouping for depreciation purposes was inaccurate, and ordered that the "equal life group" method be used. *See* Docket No. 20188 83 F.C.C.2d 267 (1980). The equal life method permitted greater precision in allocating costs of service to current consumers, and allowed more rapid capital recovery for plant having a short useful life.[3]

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2. This Court has already recognized that tandem use of telephone plant to serve both interstate and intrastate needs is quite common. *See North Carolina Utilities Commission v. F.C.C.*, 537 F.2d 787, 794 (4th Cir. 1976) ("NCUC I"), *cert. denied*, 429 U.S. 1027 (1976) (*quoting Katz v. A.T.&T.*, 43 F.C.C. 1328, 1332 (1953)), to the effect that, "[w]ere the Commission to exercise its jurisdiction only where the telephone facilities in question were exclusively interstate in character, it would result in virtually complete abdication from the field of telephone regulation. . . ."

3. For example, under the "vintage year" method, all types of telephone cable installed during one year (regardless of variations in useful lives of the cables) would be classed together and depreciated over the average useful life of the group. By contrast, the "equal life" method broke plant into smaller subgroups (*e.g.*, indoor cable as opposed to underground cable) that were depreciated separately, more in keeping with the plant's actual useful life.

Thus, while the prior "vintage year" method was thought to "stifle innovation and inhibit the introduction of new technology," 83 F.C.C.2d at 281, the "equal life" method was intended to bolster the competitive market structure that the FCC sought to foster. The same 1980 order also replaced the "whole life" method of depreciation with the "remaining life" method, which allowed a carrier to recoup the full cost of plant by making corrections in useful life estimates over time. 83 F.C.C.2d at 288-90.[4]

The FCC's 1981 order provided that inside wiring in homes and businesses no longer should be treated as a capital investment to be depreciated over time, but rather as a cost to be "expensed" to current users. Again, the thrust of the rule change was to ensure that consumers actually requesting and benefitting from installed wiring pay for that benefit. By expensing the wiring, the burden of costs associated with such station connections would be placed on the causative ratepayer, and other consumers would not be forced to bear rates unduly inflated by a depreciation component for wiring services previously provided. 85 F.C.C.2d 818, 824 (1981).

The two orders were first challenged on April 30, 1981, when the National Association of Regulatory Utility Commissioners ("NARUC") filed a Petition for Clarification of the 1981 wiring order. Specifically, NARUC requested that the FCC issue a statement that the provisions of the wiring order were not binding upon state regulatory commissions insofar as intrastate communications service was concerned. The FCC responded to the petition in a Memo-

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4. Under the "whole life" method, underrecovery had become a common problem, since carriers were locked into inaccurate, overly long estimates of useful life in an industry in which innovation and resulting obsolescence were the order of the day. *See* 83 F.C.C.2d at 289-90.

randum Opinion and Order of April 27, 1982, in which it concluded that in light of the relevant legislative history of the Act, "where state [accounting and depreciation] regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives."[5] 89 F.C.C.2d 1094, 1108 (1982).

In response to the FCC's opinion and order, the American Telephone and Telegraph Company filed a Petition for Reconsideration on June 7, 1982. General Telephone Company of Ohio likewise petitioned for a Declaratory Ruling that inconsistent state action was foreclosed under the Act.[6] After further pleadings and comments, the FCC reversed its earlier position in a second Memorandum Opinion and Order of January 6, 1983. C.C. Docket No. 79-105, F.C.C. No. 82-581, slip op. (Jan. 6, 1983). After it carefully resurveyed the legislative history and de-

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5. Writing for a 4-3 majority of the Commissioners, Secretary William J. Tricarico found that portions of the Act were geared "to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable." Tricarico also emphasized that the Commission had always given "special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission." 89 F.C.C.2d at 1106.

Commissioners Fogarty, Jones, and Rivera issued a Joint Dissenting Statement, in which they recognized the "clear preemptive thrust" of the wiring order and refused to defer to the states on a "critical capital recovery [issue] affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasingly essential interstate, as well as intrastate, facilities and services." *Id.* at 1111.

6. In its petition, General Telephone noted that the Ohio state regulatory agency had explicitly rejected use of the "remaining life" and "equal life group" methods adopted in the FCC's 1980 order. General Telephone therefore perceived a direct conflict between federal and state regulatory action, which would frustrate important interests of national communications policy.

cisional law, and reexamined the express language of the Act, the FCC adopted the view that most logical and reasonable interpretation of the Act "is that where the Commission prescribes depreciation rates for classes of property [and the depreciation methods to be used], state commissions are precluded from departing" from those rates and methods. *Id.* at 17, ¶ 44. In reversing itself, the FCC espoused the notion that the plain terms of section 220 of the Act appear "clearly to preempt the states in connection with depreciation expense determinations and the related accounting." *Id.* at 6, ¶ 17. Moreover, the FCC found that, even if section 220 did not possess a preemptive effect as a matter of law, the FCC's own policies and rulings would preempt inconsistent state regulatory action as a matter of federal supremacy. *Id.* at 17, ¶ 45.

Supported by numerous state and local regulatory commissions, the Virginia State Corporation Commission ("VSCC") filed a Petition for Review of the January 6, 1983 Order. VSCC alleged that preemption was required neither as a matter of law nor as a result of regulatory action taken by the FCC.

Relying in part on this Court's prior decisions in *NCUC I* and *NCUC II*, and relevant decisions of other Circuits,[7] we hold that inconsistent state regulation of depreciation methods and classes of property to be depreciated has been preempted by the rulings of the FCC. Because we have determined that the affirmative regulatory action taken

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7. *See Computer and Communications Industry Ass'n v. F.C.C.*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, ... U.S. ....., 103 S.Ct. 2109 (1983); *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059 (2nd Cir. 1980); and *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694 (1st Cir. 1977), discussed in text *infra*. *Contra Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n*, No. LR C 84 247, slip op. (Mar. 30, 1984) (Court holds that FCC lacked jurisdiction to issue the January 6, 1983 Order and refuses to enforce it as *ultra vires*).

by the FCC suffices to preempt inconsistent state action, we find it unnecessary to decide whether, as a matter of law, the language of the Act itself requires preemption.

II. *Discussion*

While it is true that the Act does reserve to the states the authority to prescribe rates for intrastate telephone service, that reservation is not to be read as preserving the states' sphere of intrastate jurisdiction at the expense of an efficient, viable interstate telecommunications network. Section 152(b) of the Act does make the broad pronouncement that "nothing in [the] chapter shall be construed . . . to give the Commission jurisdiction with respect to . . . intrastate communication service." Section 221(b) further supports state authority by providing that the FCC shall have no jurisdiction "even though a portion of [an] exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority."

Nonetheless, the foregoing provisions are rendered against a statutory backdrop that places primary emphasis upon a "rapid, efficient, Nationwide, and world-wide" communication service.[8] Given that overriding concern, the 1983 Opinion by the FCC construing the accounting and wiring orders of 1980 and 1981 is most reasonably interpreted as valid exercise of statutory authority by the FCC, preempting inconsistent state action by virtue of

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8. 47 U.S.C. § 151. *But see Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n*, No. LR C 84 247, slip op. at 3 (Mar. 30, 1984) (holding that FCC lacked jurisdiction to issue the January 6, 1983 Order, the Arkansas District Court refuses to permit FCC's mandate to provide efficient, nationwide service to "allow the FCC to bootstrap itself into preempting" intrastate ratemaking determinations).

the Supremacy Clause.[9] While VSCC and Petitioner-Intervenors argue that "§ 221(b) has been given an unduly narrow interpretation in recent years,"[10] we do not view as "narrow" an interpretation which recognizes that the Act does not sanction a "state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority" over interstate telecommunications. *NCUC I*, 537 F.2d at 793.

Such a finding comports well with the recent Supreme Court decision in *Fidelity Federal Savings & Loan Co. v. de la Cuesta*, 458 U.S. 141 (1982). The court stated in *de la Cuesta*, that "[e]ven where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law. Such a conflict arises when . . . state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Id.* at 153 (*quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).[11] Although the holding in *de la Cuesta* arose in

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9. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

10. Referring explicitly to this Court's decision in *NCUC I*, counsel for VSCC requested at oral argument that we "revisit" the doctrine adopted in that case, which recognized that the FCC's authority to regulate had "primacy" over state regulatory action purporting to affect the interconnection of customer-provided telephone equipment. *See NCUC I*, 537 F.2d 788 (1976).

11. Construing the Federal Alien Registration Act of 1940 in *Hines*, the Court recognized that there cannot be any "rigid formula or rule which can be used as a universal pattern" in determining Congress' intention to preempt. 312 U.S. at 67. The factual setting in which each case arises will thus shape the contours of a preemption determination.

(Continued on following page)

the context of the Home Owner's Loan Act of 1938, 12 U.S.C. § 1461 *et seq.* (1982), the basic analysis applies to this appeal as well: an appellate court is not to focus narrowly on Congress' own intent specifically to supersede state regulation. Rather, the Court must determine whether the federal agency entrusted with administering the act meant to preempt, and whether such preemptive action is within the scope of the agency's authority. 458 U.S. at 154.[12]

First, it is quite clear that the FCC did intend to preempt inconsistent state regulation governing depreciation methods and classes of depreciable property. The 1983 Memorandum Opinion and Order stated in no uncertain

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Footnote continued—

See also Pacific Gas and Electric Co. v. State Energy Resources Conservation Development Commission, ... U.S. ....., 103 S. Ct. 1713 (1983), in which the Court again noted that preemption is proper when state law frustrates important federal goals. In *Pacific Gas*, the Court found that agency regulations issued pursuant to the Atomic Energy Act of 1954, 42 U.S.C. § 2011 *et seq.* (1976), did not preempt state authority to curtail the development of nuclear power for economic reasons. Because the Nuclear Regulatory Commission's regulations dealt with plant safety, while the state regulations dealt with plant economy, compliance with both sets of regulations was possible without thwarting the federal objective. *Id.* at .....

12. The Court explicitly stated in *de la Cuesta*, 458 U.S. at 153-54:

> Federal regulations have no less preemptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. *United States v. Shimer*, 367 U.S. 374, 381-382 (1961). When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited:
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> > "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." *Id.* at 383.

terms that "we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates." C.C. Docket No. 79-105, F.C.C. No. 82-581 (Jan. 6, 1983), slip op. at 17, ¶ 45.

Second, the regulatory action taken by the FCC was also within its authority to ensure efficient operation of the interstate telephone network. In ordering that certain depreciation methods be followed, the FCC was merely exercising its power under section 220(b) of the Act to prescribe classes of property and percentages to be allowed as depreciation. To be sure, that prescription does have an effect on intrastate rates, but the effect will only be ancillary to the FCC's primary statutory directive to regulate interstate communications. While Petitioner VSCC would seek to prohibit even an ancillary effect on intrastate communications, such a result does not harmonize with the FCC's broader mission. As the FCC observed in *Katz, supra,* it is incumbent upon the FCC to exercise its authority in a manner best calculated to serve the needs of the public, and "[t]he fact that the same instruments are used for both interstate and intrastate services and that intrastate service is subject to state and local regulation does not alter the Commission's duties and obligations with respect to interstate telephone facilities." 43 F.C.C.2d at 1332.

Although the FCC noted in its 1982 Memorandum Opinion and Order that it had "never attempted to prevent any State commission from departing from [federal] accounting and depreciation rules," 89 F.C.C.2d at 1106-07, the fact of the matter is that the FCC never found it necessary to do so until the current decade. During the years of monopoly power, when state commissions tended voluntarily to follow federal directives, there was no realistic

need to speak in terms of preemption.[13] In the instant case, however, several state commissions refused to follow the FCC's determinations concerning depreciation. Although flexibility in depreciation practice presented little threat to the efficient operation of a monopolistic telecommunications industry, improper capital recovery does pose a true threat in today's competitive market. Thus, the FCC reasonably decided to preempt by issuing orders intended to speed capital recovery and improve accuracy of depreciation calculations, thereby enhancing competition.

VSCC makes much of the argument that the FCC was silent on the issue of depreciation for some forty-seven years,[14] but that prior silence does not vitiate the ongoing authority of the FCC to act once it decides that industry conditions merit preemptive regulation. As the

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13. Under section 220(i) of the Act, the FCC is required to give notice to each state commission involved, and to allow a reasonable opportunity for each commission to present its views regarding any requirements prescribed. Moreover, the FCC is required to "receive and consider such views and recommendations." Tripartite meetings were commonly held between the FCC, state carriers, and state regulatory agencies, with the FCC often able to accommodate state goals without compromising federal policy. *See* FCC Order of January 28, 1982, 88 F.C.C.2d 1223 (1982) (since late 1940s, FCC prescribed depreciation rates after conferring with carrier representatives and staffs of respective state commissions).

14. Indeed, the FCC itself observed in its initial Memorandum Opinion and Order of 1982 that it was being asked "to repudiate nearly forty years of administrative practice and applicable state court proceedings by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course.". 89 F.C.C.2d at 1107.

Nonetheless, since the FCC "is not barred from overruling past precedents when it decides that a previously declared rule is no longer sound or appropriate," *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059, 1065 (2d Cir. 1980), certainly it should not be bound to maintain silence once it determines that articulation of a uniform federal policy is warranted.

Supreme Court observed in *Smith v. Illinois Bell,* 282 U.S. 133, 159-60 (1930), a state's prerogative to regulate survives "*until* action has been taken" by a federal agency vested with jurisdiction over the matter. (Emphasis added).[15] Supporting the FCC's decision to regulate is the consideration that a full seventy-five percent of all investment in new plant falls within the intrastate services category . If that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, interstate service would then suffer the effects of delayed innovation.

As noted above, decisions of other Circuits have recognized the necessity for federal preemption of inconsistent state telecommunications policy. In *Computer and Communications Industry Ass'n v. F.C.C.,* 693 F.2d 198 (D.C. Cir. 1982), *cert. denied,* ..... U.S. ....., 103 S. Ct. 2109 (1983), it was found that state tariffing of customer premises equipment ("CPE") "must necessarily yield to the federal regulatory scheme." *Id.* at 214. The federal scheme required that charges for CPE (*e.g.,* home computer terminals, data processing units) be separated from ordi-

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15. In *Smith,* the Court found that, in the absence of federal regulatory action "which could be deemed validly to affect the amount to be charged in connection with intrastate business so as to affect intrastate rates," the jurisdiction of the state is "not to be gainsaid" in determining depreciation amounts for intrastate telephone business. 282 U.S. at 159-60.

See also Northwestern Bell Telephone Co. v. Nebraska State Railway Commission, 297 U.S. 471 (1936), in which the Court found that pending action by the FCC to establish depreciation rates, state control over such rates remained unimpaired. The Act "contemplated no restriction of state control over depreciation rates until the [FCC] had prescribed its own rate." *Id.* at 478.

Whereas the decisions in *Smith* and *Northwestern Bell* were predicated upon the FCC's inaction, the instant appeal presents a clear case of affirmative, preemptive action properly taken by the agency.

nary transmission service charges. Since CPE is used interchangeably for both interstate and intrastate service, such a decision would have a clear ancillary effect on intrastate rates. Nonetheless, the Court refused to perceive any distinction between the preemption principles to be applied in the case of state ratemaking issues, and those applicable to other state powers. *Id.* at 216. Thus, ancillary effect on intrastate rates was permitted in order to achieve the federal goals of unfettered CPE selection, market competition, and a greater number of equipment and payment options.

The Court in *Computer and Communications Industry* relied in large part on this Circuit's decisions in *NCUC I* and *NCUC II* to support preemption. In *NCUC I*, we held that state regulation that "encroaches substantially" upon federal authority was preempted. 537 F.2d at 793. The conflict in that case dealt directly with policies concerning physical interconnection of non-carrier provided CPE to transmission facilities used jointly for interstate and intrastate needs. Preemption was required, even though we recognized that the FCC had no authority "over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *Id.*

While it may be true that the effects of depreciation policies are more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines, it cannot be said that depreciation policies are "separable from" interstate communications. Indeed, the conduct and development of interstate communications would undoubtedly be affected by the states' imposition of depreciation policies that slowed capital recovery and innovation. *See also NCUC II*, in which we recognized the preemptive effect, or "federal primacy," of the Com-

mission's registration program for terminal equipment subject to interchangeable use: "If it is admitted—as we think it must be—that the FCC has full statutory authority to regulate joint terminal equipment to ensure the safety of the national network, then we can discover no statutory basis for the argument that FCC regulations serving other important interests of national communications policy are subject to approval by state utility commissions." 552 F.2d at 1046-47.

The finding of federal primacy was echoed by the Court of Appeals for the Second Circuit in *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059 (2d Cir. 1980), a case which involved an assertion of federal jurisdiction over local exchange service when used in connection with interstate foreign exchange services. Citing *Northwestern Bell* for the proposition that state regulation continued unabated only when the federal agency "had not yet regulated in [the] area," 631 F.2d at 1066, the Court held that once the FCC acted to impose its own tariff regulations, inconsistent state regulation was necessarily preempted.

Finally, the Court of Appeals for the First Circuit explicitly adopted the rationale of *NCUC I* in *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694 (1st Cir. 1977). The Court first acknowledged that federal primacy would have the "anomalous" result of ousting Puerto Rico's jurisdiction over equipment used primarily for intrastate calls. However, the Court found it "even more anomalous, in light of FCC's broad [statutory] mandate . . . that § 152(b) ousts federal jurisdiction over all facilities that are also used for intrastate telephone service." *Id.* at 700.[16]

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16. Section 152(b) provides, "[N]othing in this chapter shall . . . give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service. . . ."

It is true that *Puerto Rico Telephone,* like *NCUC I,* involved a federal policy relating to physical interconnection of CPE that was nonseverable from the interstate communications system. By contrast, the instant appeal raises no question of actual physical impossibility of complying with dual federal and state regulation; presumably, the carriers could keep accounts in which assets would be separately depreciated for intrastate and interstate purposes.[17] Nonetheless, physical impossibility is but one ground for preemption; frustration of federal objectives provides a rationale at least equally valid. Since inconsistent state regulation poses an impediment to rapid development of interstate facilities, preemption is justified in this case even if "physical impossibility" is not at issue.

In deciding the case, we have been mindful of an observation made by Chief Justice Burger when a member of the Court of Appeals for the District of Columbia in *General Telephone Company of California v. F.C.C.,* 413 F.2d 390 (D.C. Cir. 1969), *cert. denied,* 396 U.S. 888 (1969). Applying the Act in the context of cable television broadcasting, Chief Justice Burger stated that "[t]he Act must be construed in light of the needs for comprehensive regulation and the practical difficulties inhering in state by state regulation of parts of an organic whole." *Id.* at 398. To be sure, practical difficulties have come to abound in this age of technological innovation since Chief

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17. *But see People of the State of California v. F.C.C.,* 567 F.2d 84, 86 (D.C. Cir. 1977), *cert. denied,* 434 U.S. 1010 (1978). In that case, the Court observed that requiring the maintenance of " 'two redundant facilities or [investment] in expensive additional equipment' would frustrate the Commission's responsibility 'to make available, so far as possible . . . a rapid, efficient, Nationwide and world-wide wire . . . communications service with adequate facilities at reasonable charges,' " (*quoting* 47 U.S.C. § 151). Likewise, the expense associated with dual accounting could needlessly inflate the cost of services provided to consumers.

Justice Burger rendered his opinion almost fifteen years ago. In response to some of the difficulties, the FCC's decision to preempt inconsistent state depreciation practices emerges as a reasonable one, designed to foster the statutory goal of an efficient nationwide telecommunications service. Our review satisfies us that the FCC's Memorandum Opinion and Order of January 6, 1983 should be

AFFIRMED.

WIDENER, *Circuit Judge*, dissenting:

I respectfully dissent.

I am unable to agree that the FCC orders prescribing depreciation practices for common carriers' interstate operations require or warrant preemption of state regulation prescribing different depreciation methods for carriers' intrastate operations. Such preemption conflicts with the FCC's jurisdictional limitations and with this court's reading of the Supremacy Clause in *North Carolina Utilities Commission v. FCC (NCUC I)*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976), and *North Carolina Utilities Commission v. FCC (NCUC II)*, 552 F.2d 1036, *cert. denied*, 434 U.S. 874 (1977). The FCC properly recognized these limitations in its order of April 27, 1982, in which it specifically found that its prescription of new accounting procedures "does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings." *In re* Amendment of Part 31, 89 F.C.C.2d 1094, 1095 (1982), *rev'd*, CC Docket No. 79-105 (F.C.C. Jan. 6, 1983). Its order of January 6, 1983, finding that the States were preempted after all, not only violates statutory strictures on the FCC but also legal limitations on any agency making such a dramatic change in policy.

The Communications Act explicitly deprives the FCC of jurisdiction to regulate directly "charges, classifications, practices" and "facilities," among other things, for or in connection with intrastate communication service. 47 U.S.C. §§ 152(b), 221(b). Unlike other areas of the law in which the term "intrastate" has come to include virtually nothing, communication carrier accounting has until now retained a clear division between its intrastate and interstate components, and this because of the Communications Act itself. Equipment and facilities used for intrastate communications are segregated on the carriers' books from those used for interstate communications, and the States and the FCC have regulated accounting for such equipment and facilities concurrently within their respective intrastate and interstate spheres. About 75% of depreciable assets are considered intrastate. The section of the Communications Act giving the FCC authority to prescribe depreciation practices for carriers, 47 U.S.C. § 220(b), therefore cannot be read to "require preemption" of state-imposed depreciation practices for the intrastate portion of carriers' operations. More directly put, the FCC does not have jurisdiction to prescribe directly the depreciation practices to be followed as to equipment and facilities allocated to intrastate communications.[1]

The proper analysis of this case, then, is whether the state regulation of depreciation practices as to carriers' intrastate operations conflicts with the FCC regulation of such practices for carriers' interstate operations to a degree that it requires preemption of the state regulation under the Supremacy Clause of the Constitution. This

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1. As this court noted in *NCUC I*, "[T]he provisions of section 2(b) [47 U.S.C. § 152(b)] deprive the Commission of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *NCUC I*, 537 F.2d at 793.

court set forth the rule in *NCUC II* that FCC regulation of facilities and equipment must preempt contrary state regulation where the efficiency or safety of the national communications network or "other important interests of national communications policy" are at stake. *NCUC II*, 552 F.2d at 1046-47. *NCUC I* and *NCUC II* involved FCC deregulation of equipment such as subscribers' telephones used jointly in interstate and intrastate communication. When the FCC rescinded its interstate tariff preventing subscribers from providing their own telephones on the ground that the tariff violated the FCC's statutory mandate to prevent unreasonable and unjustifiably discriminatory rates, *see NCUC II*, 552 F.2d at 1042; *NCUC I*, 537 F.2d at 792, some States rejoined that they could prescribe rules forbidding consumers to connect their own telephones unless the telephones were used exclusively in interstate communication. *See NCUC II*, 552 F.2d at 1043; *NCUC I*, 537 F.2d at 790. This court found that the FCC action preempted the inconsistent state regulation, since the same telephones were used in interstate and intrastate communication and since state regulation prohibiting such connection would negate the federal tariff permitting such connection. *NCUC II*, 552 F.2d at 1043. "Something had to give." *Id.*

This sort of conflict simply is not present here. As this court noted in *NCUC I*, "[R]ate making typifies those activities of the telephone industry which lend themselves to practical separation of the local from the interstate in such a way that local regulation of one does not interfere with national regulation of the other." *NCUC I*, 537 F.2d at 793 n. 6.

The supposed conflict here is at least more attenuated, as the majority admits; in my view it is for all practical purposes nonexistent, and has been created by the FCC to

rationalize a base for its decision. The Commission claims that if the States do not follow the FCC's depreciation methods they will frustrate the FCC's policy of "encouraging competition" where market conditions will support such a policy. The FCC's claim in essence is that its newly prescribed depreciation methods, which give the carriers more revenue in earlier years, more closely reflect economic reality and thus will increase market efficiency, encourage technological innovation, and otherwise promote competition. Even if this theorizing is correct as to the effect that the FCC's prescribed depreciation procedures for the carriers' interstate operations will have on the highly competitive interstate communications market, I cannot see how nonconforming depreciation methods for the carriers' intrastate operations can frustrate competition in the interstate communications markets within which there is competition. The only rationale I can find for the FCC's position is that the States, if not required to follow the FCC's lead, will allow the carriers less revenue from the carriers' noncompetitive intrastate operations which the carriers could use to be aggressive in the small area in which they compete with the competitive interstate carriers.[2] Besides being undesirable from the standpoint of the Communications Act, this fact strikes me as encouraging to the point of requiring the use of intrastate monopoly power to finance competition with the competitive interstate market, a practice as dangerous as it is unauthorized, for monopoly should depend for its existence on serving all at reasonable rates and should not be permitted to become a financing tool for competitive ventures.

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2. I have not even considered that most of the carriers are only marginally engaged in long distance (interstate) communication, that field being dominated by AT&T and its new found competitors.

Moreover, and more fundamentally, if the FCC can achieve preemption of state-prescribed depreciation methods by reciting the shibboleth of encouraging competition with as little showing of federal-state conflict as it has made here, it has effectively written 47 U.S.C. §§ 152(b) and 221(b) out of the Communications Act. It seems to me that any ratemaking changes that the carriers want can be adopted, if they can persuade the FCC that they need the money, for any FCC adoption may be imposed on the States by virtue of the Supremacy Clause on the ground that the resultant additional revenue will help the carriers in some theoretical way to compete in some market that need not even be specified, as it was not here. The logical result of this decision is to permit the FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act.

Ironically, the FCC recognized established law and practice in holding, before it reversed itself only a little more than eight months later, that

> "[w]here state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) [47 U.S.C. § 152(b)] makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled 'important interests of national communications policy. . . .' *NCUC II*, 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes." *In re Amendment of Part 31*, 89 F.C.C.2d 1094, 1108 (1982), *rev'd*, CC Docket No. 79-105 (F.C.C. Jan. 6, 1983)."

The Supreme Court requires that "an agency changing its course. . . supply a reasoned analysis," *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 51 U.S.L.W. 4953, 4960 (1983), which must include a "rational connection between the facts found and the choice made." 51 U.S.L.W. at 4956, *citing Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962). The FCC's post-hoc reinterpretation of legislative history, on which the majority here quite properly does not depend, combined with the unsupported and unsupportable statements as to the effect on competition of inconsistent state depreciation methods, do not provide even a modicum of reasoned analysis supporting the FCC's decision to interfere in state ratemaking after several decades of affirmatively espousing the opposite conclusion.

The upshot of the case is that the FCC decided that the carriers needed more revenue than the state regulatory agencies were willing to provide, so it decided to impose different depreciation rates on intrastate equipment for the very purpose of, and thus effectively, raising the intrastate rates of the subscribers[3] just as surely as if it had done so directly. I can find neither justification nor authority in the Communications Act for this action. The final irony is the FCC justification of its action on the ground that it will " . . bring the benefits of competition to the ratepayers of this country." The "benefits of competition" are higher telephone bills for local ratepayers, and I feel confident that, like the man being ridden out of town on a rail, were it not for the honor of the thing, they had rather walk.

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3. Remarkable as it may seem, these facts are either expressly or implicitly acknowledged in para. 37 of the FCC order as well as other parts.

I note in passing that, as late as *NCUC I* (1976) 97% of the telephone calls in the country were local. The proportion could not be too different today.

MEMORANDUM OPINION AND ORDER BY THE FEDERAL COMMUNICATIONS COMMISSION

(Entered: January 18, 1983)

[CC Docket No. 79-105; RM-3017; FCC 82-581]

FEDERAL COMMUNICATIONS COMMISSION
47 CFR Part 31

Amendment With Respect to Accounting for Station Connections, Optional Payment Plan Revenues and Customer Provided Equipment and Sale of Terminal Equipment

AGENCY: Federal Communications Commission.

ACTION: Memorandum opinion and order concerning further reconsideration.

SUMMARY: The order considers a petition for reconsideration filed by the American Telephone & Telegraph Co. and a petition for Declaratory Ruling filed by General Telephone of Ohio. Both petitions request that the Commission assert preemptive assertion with respect to depreciation policies and rates. On further reconsideration, the Commission reversed its earlier holding that states were free to follow accounting and depreciation practices of their own choosing for intrastate ratemaking. The order finds that Section 220(b) of the Communications Act of 1934, as amended, preempts state depreciations rates that are inconsistent with those prescribed by the FCC. Alternatively, the order finds that even if Section 220(b) were construed not to preempt, the Commission would preempt inconsistent state depreciation rates to avoid the frustration of federal policies. The order also grants the Petition for Declaratory Ruling. The first reconsideration order was printed at 47 FR 19361 (May 5, 1982).

ADDRESS: Federal Communications Commission, Washington, D.C. 20554.

FOR FURTHER INFORMATION CONTACT: Douglas Slotten, 202-632-9342.

SUPPLEMENTARY INFORMATION:

List of Subjects in 47 CFR Part 31

Communications common carriers, Telephone, Uniform systems of accounts.

Memorandum Opinion and Order

Adopted: December 22, 1982.

Released: January 6, 1983.

In the matter of amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and customer provided equipment and sale of terminal equipment; petition for declaratory ruling on question of Federal preemption involving order of the Public Utilities Commission of Ohio in Conflict with (i) FCC Prescriptions Under Section 220 of the Communications Act and (ii) Established FCC Policies.

1. The Commission has before it a Petition for Reconsideration filed on June 7, 1982, by the American Telephone and Telegraph Company, on behalf of itself and the associated Bell System Operating Companies (AT&T). AT&T seeks reconsideration of the Commission's decision in *Amendment of Part 31*, 89 FCC 2d 1094 (1982) (hereinafter cited as *Preemption Order*), in which the Commission determined that Sections 220(a) and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C.

220(a) and 220(b), did not preempt state commissions from applying different accounting and depreciation procedures for purposes of intrastate ratemaking proceedings.[1] The *Preemption Order* was a reconsideration of *Amendment of Part 31*, 85 FCC 2d 818 (1981) (hereinafter cited as *Expensing Order*).

2. The Commission also has before it a Petition for Declaratory Ruling filed on June 7, 1982, by General Telephone Company of Ohio (GTE of Ohio). This petition requests that the Commission preempt an order of the Public Utilities Commission of Ohio (Ohio) that denied GTE of Ohio the same depreciation rates for intrastate purposes as had been prescribed by this Commission. GTE of Ohio contends that Section 220(b) established the rate prescribed by the Commission as the only depreciation rate the company could utilize.

3. The Commission established a joint reply period for the two petitions, utilizing the pleading cycle for comments in response to the Petition for Reconsideration, and allowed parties to cross-reference their pleadings where appropriate. In addition to pleadings filed by the petitioners and the GTE parties, comments or reply comments were filed by the Arkansas Public Service Commission (Arkansas), Ohio, the People of the State of California and the Public Utilities Commission of the State of California (California), the Virginia State Corporation Commission (Virginia), the National Association of Regulatory Utility Commissioners (NARUC), the United States In-

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1. On June 8, 1982, GTE Service Corporation, on behalf of itself, United Telephone System, Inc., and Continental Telecom, Inc. (hereinafter referred to as GTE), filed a Petition for Clarification of the Commission's *Preemption Order*. This petition was dismissed as untimely. *Amendment of Part 31*. Mimeo No. 4766 (released June 24, 1982). However, the Commission stated that it would consider the substance of the petition in connection with AT&T's petition.

dependent Telephone Association (USITA), the Office of Consumers' Counsel, State of Ohio (Consumers' Counsel), the United Telephone System Inc. and the Idaho Public Utilities Commission (Idaho). A summary of the comments is contained in Appendix A. Below we consider the issues raised on reconsideration, after which we shall consider the question presented by GTE of Ohio's Petition for Declaratory Ruling.

I. Background

4. In *Docket No. 19129*, 64 FCC 2d 1, 54-56 (1977), we concluded that it would be desirable to have the causative rate payer bear the costs associated with station connections. We directed AT&T to file a plan for accomplishing this objective. Following AT&T's submission we initiated this proceeding, albeit with a somewhat different approach for modifying the accounting for station connections than proposed by AT&T.

5. After reviewing the comments, we concluded that the drop, block and protector portion of station connections should not be included in any accounting or regulatory revisions. We also concluded that our objective of placing the costs of station connections on the cost causative customer could not be achieved by means of an accounting change alone. This is so because costs associated with the provision of inside wiring must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual jurisdiction. Complete unbundling could be achieved by requiring inside wiring to be provided on a detariffed basis, as was done with customer premises equipment. Accordingly, we initiated a further inquiry to explore the detariffing concept further, *Amendment of Part 31*, 85 FCC 2d 885 (1981).

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would begin expensing the inside wiring portion of the station connection account would be in the public interest, and would facilitate the deregulation of the provision of inside wiring if the Commission should later decide to take that approach. The principal changes required that future costs of installing inside wiring and similar costs be included as an expense in Account 605, Repair of Station Equipment. Such costs were previously capitalized in Account 232, Station Connections. The expensing of these costs would be phased in over a four year period unless a carrier obtained state commission approval to expense one hundred percent immediately. The *Expensing Order* also required that the present net investment in inside wiring and the investment capitalized during the phase-in period be amortized over a ten year period. These expensing and amortization rules replaced the depreciation procedures that had previously applied to the inside wiring portion of the station connections account.

7. On reconsideration, we concluded that the *Expensing Order* was not intended to preempt state commissions from utilizing other depreciation or accounting procedures for intrastate ratemaking proceedings, unless such preemption occurs as a matter of law. Our discussion was based in part on an assumption that most or all of the state commissions would follow our lead. We also indicated that Section 220 does not preclude state commissions from departing from accounting and depreciation rules prescribed by this Commission for purposes of regulating intrastate communications services. In reaching this conclusion, we reviewed Section 20(5), the Interstate Commerce Act predecessor of the accounting and depreciation provisions contained in Section 220. We concluded

that nothing in the history of Section 20(5) provided any indication of whether that provision had been intended to preempt state commissions from prescribing divergent depreciation rates when the Interstate Commerce Commission (ICC) had prescribed a rate. We stated:

> [i]nasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analogous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result.

Preemption Order, supra at 1102.

8. We also reviewed the legislative history of the Communications Act and concluded that Congress had been uncertain of the preemptive effect of reenacting the Interstate Commerce Act language and that it apparently did not want to resolve the question at that time. We concluded that Congress had been attempting to obtain as much uniformity as possible without coercing any state commission to use ratemaking methods which it might find unacceptable. We found that we had proceeded in a manner consistent with this purpose for nearly four decades, noting that we had recognized divergent practices by state commissions from time-to-time. The language of Section 2(b)(1) was found to support the interpretation that state commissions are not precluded from applying different accounting and depreciation procedures from this Commission. The *Preemption Order* concluded by finding that nothing in the Act precluded us from preempting

state commission action that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate or foreign communications, but we also found that federal regulation would not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

II. Discussion

9. The question presented in the reconsideration petition is a clearly delineated controversy over whether Section 220(b) preempts state depreciation prescriptions that are inconsistent with the rates prescribed for classes of property by this Commission, or, whether Section 2(b)(1) of Section 221(b) reserve to the states the right to prescribe their own depreciation rates for intrastate regulatory purposes. Alternatively, it is argued that the Commission should preempt inconsistent state depreciation rates pursuant to its authority to preempt state actions which would frustrate or interfere with the accomplishment of federal objectives. *See North Carolina Utilities Commission v. FCC*, 537 F.2d 737 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976) (hereinafter cited as *NCUC I*). The Preemption Order was the first time the Commission had squarely addressed the preemptive effect of a prescribed depreciation rate, despite having prescribed rates for more than thirty years. No federal court has addressed the question of the preemptive effect of a Commission prescribed depreciation rate.[2]

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2. The United States Supreme Court has held that state commissions may prescribe depreciation rates where the empowered federal commission has not prescribed rates. *Northwestern Bell Telephone Co. v. Nebraska State Railway Comm.*, 297 U.S. 471 (1936). The Court specifically reserved judgment on the effect of prescribed rates by the federal commission.

10. It is argued that the Commission erred in the earlier decision by concentrating on Sections 220(a), and 220(g) rather than properly analyzing Section 220(b), the provision dealing directly with depreciation. A careful review of AT&T's and GTE's pleadings and a thorough re-evaluation of the entire question of the Commission's depreciation jurisdiction leads to the conclusion that the evaluation in the Preemption Order did not sufficiently consider the effect of Section 220(b). Accordingly, we shall undertake to evaluate anew the scope of the Commission's jurisdiction under Section 220(b).

11. Before turning to the analysis of the statutory provisions, it is necessary to understand the relationship between capitalizing and expensing a transaction or economic event. When an event is capitalized, its cost is recorded on the company's books to be recovered over some future period through depreciation charges to operating expense. Depreciation as used here is an accounting convention for allocatively spreading the original cost, less net salvage, over the useful life of a capital asset. Thus, for there to be depreciation there must be costs that are to be recovered over more than one accounting period. However, when the decision to expense is made, all costs are to be recovered at one time. Thus, the decision to expense is a determination that there is no category of asset for which depreciation expense will be allowed. It is therefore clear that the decision to commence expensing the inside wiring portion of station connections involves questions of depreciation policy.

12. The law is clear that federal regulation should not be presumed to preempt state regulations without clear evidence of either congressional design to preempt the field or that state regulatory activities would obstruct the accomplishment and execution of the full purposes and ob-

jectives of Congress. *Florida Lime and Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 141 (1963), *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941). Our review reveals that both criteria are satisfied in this case. In reaching this conclusion we analyzed the language of Section 220, the legislative history, relevant court cases, and our regulatory objectives.

A. Statutory Language

13. The Commission's express jurisdiction with respect to depreciation is set forth in Section 220(b). That section provides:

> The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

14. The plain language of the statute is express and unequivocal. Section 220(b) says the Commission "shall" make depreciation prescriptions, and that carriers "shall not" charge depreciation different than that prescribed by the Commission. That this preempts inconsistent state action is further indicated in Section 220(h) which gives the Commission discretion to "except" carriers from the requirements of Section 220 "where such carriers are subject to state commission regulation."

15. The requirement of Section 220(i) that states be given an opportunity to comment before the Commission prescribed "any requirements as to accounts, records and memoranda" is consistent with an interpretation that states are preempted when the Commission has acted in the depreciation area. By providing that states be given notice, Congress ensured that state needs for accounts, records and memoranda brought to the Commission's attention would be considered. Such a procedure assures that the states' needs and legitimate interests are met.

16. In setting the duties of the Commission and the prohibitions on the carriers subject to the Act, Congress spoke of depreciation in general terms without any attempt to make distinctions between either "intrastate" or "interstate" property. This is significant because when Congress wanted to make such distinctions in the Act it did so. *See, e.g.*, U.S.C. 221(c) and (d), and 410(c). The fact that Congress did not make such a distinction here indicates that it intended no distinction.

17. Taken as a whole, the language of Section 220 appears clearly to preempt the states in connection with depreciation expense determinations and the related accounting. The language strongly implies that the states may not depart from depreciation rules prescribed by the

FCC unless the Commission in its discretion allows them to do so. Otherwise, the federal statute would govern state depreciation practices in form only, allowing the states to treat substantive depreciation matters as they might choose. While that might be a plausible construction of Section 220, after full analysis we do not believe that Congress intended such a feeble gesture. There would be little purpose to require the carriers to keep all their books pursuant to an FCC prescription, and then allow the states to require the carriers to follow inconsistent depreciation practices. Instead, the language of the section and the comprehensive treatment given to this matter by the Congress demonstrate that more was intended. Accordingly, we find that the statutory language indicates that FCC depreciation prescriptions are to be followed in both the federal and state jurisdictions unless the FCC provides otherwise. As demonstrated below, this construction is also consistent with the legislative history.

B. Legislative History

18. In the Preemption Order we found that the legislative history of Section 220 was inconclusive and at most indicated that Congress was "not sure" about the preemptive effect of the new legislation. 89 FCC 2d at 1106. However, the reconsideration petition and comments supporting it show that Congress believed that the language ultimately adopted would preempt the states from prescribing depreciation rates for subject carriers when the Commission had prescribed rates.

19. In our Preemption Order, we observed that Section 220 of the Communications Act had been adopted from Section 20 of the Interstate Commerce Act, and our review of the few ICC cases touching upon preemption did not reveal the ICC to have possessed the kind of broad pre-

emptive power now urged by GTE and AT&T. However, after reviewing the pre-1934 cases again, we find that, while not dispositive, they lean more toward GTE and AT&T's views than against them.

20. The closest the ICC came to delineating its position on this matter came in *Depreciation Charges of Telephone Companies*, 118 I.C.C. 295, 332 (1926), where it said:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation.

In the Preemption Order we focused on the fact that the ICC had not actually prescribed depreciation rates and thus there was uncertainty regarding the ICC's actual authority. However, after reviewing that case again we find that the better and more sensible interpretation is that if the ICC had prescribed depreciation rates, the state commissions would have been precluded from prescribing rates that diverged from those it prescribed. We cited *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 159 (1930), in the Preemption Order as supporting our conclusion that the ICC decision did not preempt the states. In that decision the Supreme Court held that absent ICC action prescribing depreciation rates, Section 20(5) did not preclude states from prescribing depreciation rates. Since the ICC proceeding did not actually prescribe depreciation rates, but only began a proceeding looking toward the ultimate prescription of depreciation rates, there were

no depreciation rates prescribed that could have preempted state-prescribed depreciation rates. Thus, *Smith* only stands for the proposition that until the ICC actually prescribed rates, there was no basis for preempting the states. It did not reach the question of whether Section 20(5) would preempt the states if the ICC prescribed depreciation rates.[3]

21. At the hearings pertaining to the Communications Act the then chairman of the ICC indicated his belief that the ICC depreciation rulings would govern both federal and state depreciation practices:

> Paragraph (j) * * * should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law.[4]

22. Other witnesses who appeared at the hearings repeated the same view. See statements of Mr. Gifford,[5] Mr. Benton,[6] and Dr. Irvin Stewart.[7]

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3. Similarly, *Interstate Commerce Commission v. Goodrich Transportation Co.*, 224 U.S. 194 (1912) and *Kansas City Southern Ry. Co. v. I.R.S.*, 52 F.2d 372 (8th Cir. 1931) do not appear to have any pertinence to the issue at hand. As noted in 89 FCC 2d at 1099, *Goodrich* did not raise any question with respect to the effect of ICC accounting rules upon activities not subject to ICC rate regulation. The *Kansas* holding simply reconciles two federal statutes, the Internal Revenue Code and the Interstate Commerce Act. It did not purport to establish new law on state preemption.

4. Ltr. of F. McManamy, Hearings on S. 2910, p. 208.

5. Hearings on H.R. 8301, pp. 191-192 (See 89 FCC 2d at 1105, fn. 17). The Preemption Order had indicated that Mr. Gifford's preemption views were tentative. However, careful review of that testimony reveals that Mr. Gifford's uncertainty may have concerned the date Section 20(5) was enacted, not preemption.

6. Hearing on S. 2910, 73rd Cong., 2d Sess., p. 181 (1943).

7. Hearings on H.R. 8301, 73rd Cong., 2d Sess., p. 17 (1934).

23. The Preemption Order relied heavily on the "silence contained in the Congressional Reports," 89 FCC 2d 1105, in concluding that the legislative history did not support a finding that Section 220 was intended to preempt state commissions from prescribing their own depreciation rates for intrastate purposes. However, a reexamination of the legislative history in light of the comments on reconsideration indicates that the committee reports accompanying the bills did contain language indicating that the committees believed that the predecessor provision had preempted the states. The House Report, in discussing the Section 220(j) provision (which was not adopted) that would have reserved jurisdiction over depreciation rates to the states for purposes of intrastate ratemaking, stated that the provision was "responsive to the requests of the State commissions that the present law be changed so as to permit those bodies to exercise, for State purposes, certain jurisdiction over . . . depreciation accounting."[8]

24. In remarks on the House floor, Representative Rayburn, Chairman, House Committee on Interstate and Foreign Commerce, explained Section 220 of the proposed bill as follows:

> [p]aragraphs (a) to (g), relating to accounts records, memoranda, and depreciation, are based upon sections

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8. H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934) (emphasis added). The section (j) proposed by the House would have provided: "Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State Law." H.R. 8301, 73rd Cong. 2d Sess. Section 220(i) (February 27, 1934).

> 20(5) to (8) of the Interstate Commerce Act with changes necessary to permit State commissions to prescribe the systems of accounts for the intrastate operation of carriers. Paragraphs (h) to (j) are new . . . paragraph (j) removes any limitation upon the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction, rates of depreciation. The last three paragraphs named were placed in the bill at the request of the State commissions which feel that their task of regulating intrastate communications will be greatly facilitated by the adoption of these paragraphs.[9]

25. The Senate version of Subsection (j) took a totally different approach than the House version. It called "for investigation and report to Congress instead of immediately turning over these matters to the State." S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934).[10] The version of Section 220(j) finally enacted was the result of agreement in the conference committee. The conferees agreed to adopt the House provisions as to Sections 220(h) and (i), but decided against the House Section 220(j) proposal to remove any limitation upon the power of states to prescribe rates of depreciation. Instead, Section 220(j) was modified along the lines of the Senate

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9. 78 Cong. Rec. 10314 (1934) (emphasis added).

10. The Senate version of Section 220(j) provided: "The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentage rates of depreciation or systems of accounts records, or memoranda to be kept by carriers." S. 3235, 73rd Cong. 2d Sess. Section 220(j) (March 28, 1934).

proposal to require the Commission to "investigate and report to Congress as to the need for legislation to define or further harmonize the powers of the Commission and of State commissions with respect to other matters to which this section relates." Conf. Comm. Rep. No. 1918, 73rd Cong., 2d Sess. 17 (1934). The obvious inference to be drawn is that the conferees were not prepared at that time to allow the states to prescribe depreciation rates different than those established at the federal level, but that matter might be considered later if the report required by Section 220(j) indicated it to be appropriate.

26. The hearing testimony and Committee reports therefore indicate that the language being recodified from Section 20(5) of the Interstate Commerce Act preempted the state commissions' jurisdiction over depreciation. The rules of statutory construction provide that where Congress reenacts a provision from an existing statute, it intends that the construction applicable to the existing provision apply as well to the new provision.[11] The legislative history thus supports the actual language of Section 220(b) and indicates that Congress intended to preempt state commission jurisdiction over depreciation rates for subject carriers when it recodified the language from the Interstate Commerce Act. Accordingly, we conclude that the analysis of the legislative history contained in the comments of AT&T and GTE accurately represents the intent of Congress and that the more persuasive reading of the legislative history supports the construction that Section 220(b) preempts inconsistent state action where the Commission has prescribed depreciation rates for a carrier.

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11. Courts have given weight to interpretations of the Interstate Commerce Act in interpreting the Communications Act. *See, e.g., American Telephone and Telegraph Company v. FCC*, 487 F.2d 865 (2d Cir. 1973).

C. Administrative and Court Decisions

27. The Preemption Order cited *Accounting Rules for Telephone Companies,* 203 ICC 13 (1934), as evidence that the FCC could not preempt state depreciation practices. There the ICC recognized that states might have additional accounting needs and indicated that it had permitted state-prescribed sub-accounts within the federally-required books of account. However, the adoption of a blanket subdivision rule does not lead to the conclusion that federally adopted accounting and depreciation rules are not preemptive. Rather, it reflects an awareness that state commissions may have special data requirements to properly administer their regulatory policies which may require additional detail beyond that prescribed by the federal agency. A subdivision rule, however, does not permit what is accounted for as an expense to be capitalized in the guise of subdividing an expense account. While we may allow subdivisions of accounts, we will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest. Any other policy would obliterate the prescriptive effect of our adoption of a uniform system of accounts.

28. In fact we have approved variations from the prescribed uniform system of accounts. For example, our rules give carriers blanket authority to subdivide certain prescribed accounts "provided such subdivisions do not impair the integrity of the accounts prescribed." 47 CFR 31.01-2(d)(1). CFR 31.01-2(f), authorizing carriers to subdivide accounts "in the manner ordered by any state commission having jurisdiction * * *" We also have approved state commission rate making treatment of plant under construction different from that adopted by us. See 89 FCC 2d at 1107.

29. There may well have been some instances of inconsistent state treatment of depreciation in the past. However, we do not seek controversy unless it is necessary to protect vital federal interests. Either such instances did not come to our attention or they may not have appeared threatening to federal interests.[12] In the past the communications marketplace was typified by monopoly conditions and life and salvage factors underlying the state rates were generally very similar, if not identical, to those used by the Commission. In that environment it was not essential that the Commission assert all the authority granted it. *See Computer and Communications Industry Association v. FCC,* No. 80-1471 (D.C. Cir. November 12, 1982). As discussed, *infra,* in the more competitive conditions prevailing today, the utilization of proper methods and rates is more critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of that competition to the ratepayers of this country. Therefore, where it is necessary to protect important federal policies against frustration by inconsistent state actions, we will exercise the full breadth of our depreciation powers. *See* para. 14 above.

30. Nor is there any merit to the argument that federal preemption of depreciation practices constitutes intrastate ratemaking which might run afoul of 47 U.S.C. 152(b). Section 220(b) only prohibits the states from setting depreciation rates for telephone property inconsistent from those prescribed by the FCC. It does not require that any particular tariff for intrastate service be accepted by the state commissions. The setting of

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12. *Pacific Telephone and Telegraph Company v. California,* 401 P.2d 353 (1965), was cited in the Preemption Order to support nonpreemption. However, the California Supreme Court did not analyze Section 220(b) or its legislative history and its determination is therefore unpersuasive.

depreciation rates and classes of depreciable property only resolves a single issue impacting the ratemaking process. It does not restrict the state commission's broad discretion in setting charges for individual services. In any event, Section 2(b) of the Act, 47 U.S.C. 152(b), has a well defined purpose which would not be implicated here: "To restrain the Commission from interfering with those essentially local incidents and practices of common carriage by wire that do not substantially encroach upon the administration and development of the interstate telephone network." *NCUC I, supra* at 794 n.6. Here the setting of depreciation rates is not an essentially local incident or practice and it has substantial effects upon the administration and development of the interstate telephone network.[13]

D. Preemption Under Federal Supremacy

31. Even if one were to assume that Section 220(b) did not automatically preempt the states whenever this Commission has acted, federal preemption of inconsistent state depreciation would be justified in this case to avoid frustration of validly adopted federal policies. The Fourth Circuit has stated:

> We have no doubt that the provisions of section 2(b) deprive the Commission of regulatory power over local services, facilities and disputes that in their

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13. Nor is federal preemption of depreciation practices inconsistent with 47 U.S.C. 221(b). Section 221(b) was intended to reserve state jurisdiction over exchange rates where exchange boundaries extend over two states. That provision was not intended to create new reservations to the states beyond that contained in Section 2(b) and the narrow circumstances encompassed by interstate exchanges. *See Computer and Communications Industry Association v. FCC, supra,* and *North Carolina Utilities Commission v. FCC,* 552 F.2d 1036, 1046 (4th Cir. 1976), *cert. denied,* 434 U.S. 874 (1977) (hereinafter cited as *NCUC II*).

> nature and effect are separable from and do not substantially affect the conduct or development of interstate communications. But beyond that, we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under sections 201 through 205.

NCUC I, supra at 793. To the same effect, see *Computer and Communications Industry Association v. FCC, supra* at 35.

32. The D.C. Circuit recently addressed the preemption question, observing:

> We fail to see any distinction in this case between preemption principles applicable to state ratemaking authority and those applicable to other state powers. The operative principle [is that] . . . preemption of state tariffs on CPE is justified because state tariffs would interfere with the consumer's right to purchase CPE separately from transmission service and would thus frustrate the validly adopted federal policy.

Id. at 38. The court went on to find that conflicting state regulation may be preempted even though there is some indirect effect on state ratemaking discretion, noting:

> the Act itself does not distinguish between authority over rates and authority over other aspects of communications. Sections 2(a) and (b) of the Act allocate federal and state authority with regard to both "charges [and] * * * facilities." Therefore, conflicting federal and state regulations regarding dual use CPE are no more acceptable under the Act when equipment rates are involved, as here, then when

intercommunication policies are involved, as in the *NCUC* cases.

Id. at 38-39.

33. The provision for adequate capital recovery is important to "make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, worldwide wire and radio communication service with adequate facilities at reasonable charges * * *." 47 U.S.C. 151. State depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment, which constitutes this Commission's policy in those markets found capable of supporting competition, would frustrate the accomplishment of that policy and are preemptable by this Commission.

34. Over the past decade the Commission has embarked in several areas of telecommunications to pursue a policy of encouraging competition wherever the market conditions will support such a policy and produce benefits to the public interest. In *MTS-WATS Market Structure Inquiry,* 81 FCC 2d 177 (1980), the Commission opened the domestic MTS-WATS market to competitive entry, reserving the question of entry to Alaska to a later phase since concluded with the adoption of a similar open entry policy, *MTS-WATS Market Structure Inquiry,* FCC 82-515 (released November 30, 1982). In *Computer Inquiry II,* 77 FCC 2d 384 (1980), *recon.,* 84 FCC 2d 50 (1980), *recon.,* 88 FCC 2d 512, *aff'd sub nom., Computer and Communications Industry Association v. FCC, supra,* the Commission opened the areas of enhanced services and customer premises equipment to competitive provision. These are just two examples of the policies which the Commission has pursued. However, they do point up the fact that if this policy is to be successful, it will be necessary for

the marketplace to operate efficiently. Such efficient operation requires proper price signals generating from supply and demand conditions.

35. Capital recovery is an important determinant of the price at which services can be offered and significantly affects the amount of facilities provided to supply the needs of the communications industry. In *Amendment to Part 31,* 83 FCC 2d 267 (1980), *recon.,* 87 FCC 2d 916 (1981), the Commission adopted remaining life and straight line equal life group depreciation methods that recover capital on a basis that approximates straight line unit depreciation more closely than did the previously used methods. More timely capital recovery was anticipated to result in faster technological innovation with its accompanying benefits of more efficient service provision and lower costs resulting from more productive use of facilities.

36. Capital recovery issues are important in the implementation of *Computer Inquiry II* due to the part depreciation plays in the determination of net book value and the resultant gain or loss that may occur on the transfer of assets to the new subsidiary. It will also be significant in any later transfer of assets from the provision of regulated service to unregulated service or vice-versa. Thus, appropriate capital recovery will ease the regulatory burdens associated with supervising the transition to the new structure.

37. Depreciation is a significant portion of the revenue requirement of the regulated telephone companies. As such, it plays an important role in determining the price at which they offer their services. If competition is to be viable, it is necessary for prices to reflect depreciation expenses that are realistic for a competitive mar-

ket. Absent such depreciation levels, improper signals will be given to the market. Since most plant is used interchangeably to provide interstate and intrastate communications service, supply and demand is determined by the combination of inputs from service demand in both regulatory jurisdictions. Approximately 75 percent of exchange plant is allocated to the intrastate jurisdiction. It is clear that unless telephone plant, including that portion subject to allocation to the intrastate jurisdiction, is depreciated at a reasonable rate, improperly timed capital recovery will occur. Indeed, in an increasingly competitive environment, it is possible that improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital. Moreover, the extent of state action attempting to prevent carriers from utilizing our depreciation prescriptions places substantial burdens on carriers and could well impair their ability to raise the investment capital they will need to fully compete in the continually evolving competitive telecommunications marketplace.[14] Such a result could undermine the achievement of the Commission's objective to develop policies that will engender a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices.

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14. AT&T and GTE indicate several state commissions have refused to follow, have indicated an intent not to follow, or are being urged not to follow Commission determinations with respect to the expensing of inside wiring and/or the adoption of straightline equal life group or remaining life depreciation methods. A staff review of state action in conjunction with AT&T intrastate tariff proceedings reveals that all but two states have approved expensing of station connections, that 13 states have rejected and 12 have approved equal life group depreciation, and that 9 states have rejected and 22 have approved remaining life group depreciation. Prior to issuing our Order in this docket we did not expect that such significant variance would be required by states.

38. NARUC contends that preemption with respect to station connections is unnecessary and will not produce competitive benefits because expensing is not the same as unbundling. While NARUC is correct in a strict sense, it avoids the critical issue, which is the proper timing of cost recovery. If the Commission preempts with respect to station connections and all states must expense these costs, current ratepayers will be paying these costs instead of future ratepayers as would be the case with capitalization. Thus, future prices will reflect the appropriate costs for providing those services. Moreover, if these costs are expensed and state commissions must allow rates to cover these costs, it is likely that the cost causative ratepayer will in many cases be charged for the costs being expensed in connection with the provision of inside wiring. Thus, the Commission's objective may be substantially achieved by preempting state commissions from departing from our expensing rules.

39. In 1971 Congress amended the Communications Act to change the procedures for allocating costs between federal and state jurisdictions by adding Section 410(c). The Commission was given the ultimate authority with respect to such allocations, further solidifying its superintendency over common carrier communications. *See NCUC I, supra* at 795. Section 410(c) procedures provide for uniformity in the separations process, thereby insuring that plant, expenses and revenues will be rationally accounted for in the dual jurisdictional environment. The utilization of one depreciation rate is the most effective method for insuring that this uniformity will be maintained and to insure that no jurisdiction bears a greater burden than another in the transition to a fully competitive marketplace. Several parties suggest that under or over recovery will result from one jurisdiction or another be-

cause of the shifting usage patterns for telephone plant over time and argue that if such a result were to occur, significant inequities would result to both ratepayers and carriers. A uniform depreciation rate for each class of property applicable to all property whether allocated to the federal or state jurisdiction clearly eliminates these potential problems.

40. For all of these reasons, it is apparent to us that a substantial impact on federal policies could result if state commissions were allowed to diverge from Commission prescribed depreciation rates and practices. Accordingly, it is essential to preempt inconsistent state depreciation practices to avoid frustration of these vital national policies.

III. Declaratory Ruling Petition

41. GTE of Ohio seeks to have the Commission preempt an order of the Ohio Public Utilities Commission that did not approve remaining life and equal life group rates for intrastate ratemaking purposes. As alleged by GTE of Ohio, the differential in rates amounts to seven million dollars per year. GTE of Ohio states that failure of this Commission to preempt the state will frustrate the achievement of federal policies adopted by this Commission. Its argument is similar to those cited in connection with the reconsideration petition.

42. Essentially the same arguments are made against the GTE of Ohio petition as were urged on reconsideration with regard to the substance of the issue. However, Ohio cites an Ohio statute that precludes the state commission from adopting remaining life depreciation for intrastate purposes.

43. One procedural argument is raised by Ohio with respect to the petition. It contends that the question

presented is premature since the order is subject to further reconsideration before the Ohio Commission pursuant to a request filed by GTE of Ohio. We do not agree since the purpose of declaratory rulings is to give guidance to affected persons in areas where uncertainty or confusion exists. A case or controversy in the judicial sense is not required, *NCUC I, supra* at 790-1. In this case, it appears necessary to issue such a ruling to clarify for the state commissions and the carriers the effect of our depreciation prescriptions. The fact that reconsideration proceedings are underway in Ohio does not mitigate against such a course in light of the divergencies from this Commission's depreciation methods and rates that are occurring to the detriment of federal policies. Thus, we find it imperative to declare today that inconsistent state prescribed depreciation rates are preempted by the Communications Act and are accordingly void. The existence of a state statute preventing a state commission from adopting a particular method does not affect this determination. When federal preemption is involved, there is no difference between a statute or a regulation of a state commission. Both must fall in the face of overriding federal concerns and policies.

IV. Conclusion

44. We have carefully reviewed the record upon reconsideration. The issues raised concerning the Preemption Order caused us to reevaluate the statutory language of Section 220(b), the legislative history of the provision, and the relevant judicial and administrative proceedings relating to the subject. Our considered judgment after this review is that the Preemption Order must be reconsidered. We find that the most logical and reasonable interpretation of Section 220(b) of the Act is that where the Commission prescribes depreciation rates

for classes of property, state commissions are precluded from departing from those rates. Since the depreciation method utilized is a material part in determining the rate to be applied, state commissions are also precluded from departing from the depreciation methods prescribed by the Commission. Thus, the Expensing Order is binding upon state commissions and they must expense additions to inside wiring in accordance with the plan established therein. Moreover, they must follow the amortization procedures adopted in that decision for the embedded inside wiring and any additions to the capitalized amount as a result of the phase-in of the expensing of inside wiring.

45. Even if Section 220(b) does not preempt state commissions, we would act under our authority to preempt state actions that interfere with the accomplishment of federal policies and objectives. *Computer and Communications Industry Association v. FCC, supra,* and *NCUC II.* We note that petitioner and the parties supporting the petition cite several states that have indicated they do not intend to follow the Commission's depreciation prescriptions or expensing of inside wiring, or have refused to follow either. In light of the concerns expressed about an efficiently functioning market, we must find that inconsistent depreciation rates prescribed by state commissions will interfere with the efficient operation of the communications marketplace and thereby frustrate the achievement of the Commission's policies. Accordingly, we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates.

46. Accordingly, it is ordered, pursuant to Sections 1, 4(i), and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C. 151, 154(i), and 220(b), that the

Petition for Reconsideration filed by the American Telephone and Telegraph Company is granted.

47. It is further ordered, that the Petition for Declaratory Ruling filed by General Telephone Company of Ohio is granted to the extent reflected herein.

48. It is further ordered, that the Secretary shall cause this order to be published in the Federal Register.

49. It is further ordered, that the Secretary shall cause a copy of this order to be served on each state commission.

Federal Communications Commission.
William J. Tricarico, Secretary.

Note: Due to the continuing effort to minimize publishing costs the Appendix of this document (Summary of Comments) will not be printed herein. However, copies of this document in its entirety are available from any of the distribution centers listed in the FCC Office of Public Affairs, Room 202, 1919 M St., N.W., Washington, D.C. 20554, (202) 234-7674. In addition, a copy is available for public inspection in the FCC Dockets Branch, Rm. 239, and the FCC Library, Rm. 639, both located at 1919 M St. N.W.

Separate Statement of Commissioner Joseph R. Fogarty.

In Re: Reconsideration of Docket No. CC 79-105.

Having dissented from the Commission's original decision declining to preempt State accounting and depreciation rules inconsistent with those prescribed by the FCC,[1] I am pleased that the Commission has reconsidered this issue and acted to preempt such inconsistent State regulation.

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1. Amendment of Part 31, Joint Dissenting Statement of Commissioners Joseph R. Fogarty and Anne P. Jones, 89 FCC 2d 1109-1111 (1981).

As this Order establishes in detail, a true reading of the statutory language and legislative history of Section 220(b) of the Communications Act clearly demonstrates that Congress intended FCC depreciation rules and policies to control the field.

Even if preemption were not explicitly mandated by Section 202(b), the effective implementation of our pro-competitive federal telecommunications policies dictates that inconsistent State depreciation regulation be preempted by this Commission. We cannot "defer to the States" on capital recovery issues. Telephone companies must be able to recover their cost of capital in a timely and effective manner if they are to price their services efficiently and to improve and expand their facilities to meet the challenges of competition and technologic innovation.

This preemption imperative is not merely theoretical. Too many States (e.g., Alabama, Louisiana, Nebraska, Ohio, New Jersey, Michigan, Arkansas) have already refused to recognize the critical necessity of the FCC's cost recovery principles. The resulting depreciation rate differentials are alarming: GTE of Ohio has indicated that it will be denied $7 million in capital recovery this year if the State of Ohio's disparate depreciation treatment is allowed to prevail.

The FCC cannot ignore the detrimental impacts of inconsistent State treatment of depreciation if our pro-competitive policies are to have any integrity and viability. This Commission now recognizes that preemption is both mandated as a matter of law and essential as a matter of policy, and our action today has my full endorsement and support.

[FR Doc. 83-1348 Filed 1-18-83; 8:45 a.m.]

BILLING CODE 6712-01-M

JUDGMENT ENTRY OF THE OHIO SUPREME COURT

(Entered: July 25, 1984)

No. 83-392

THE SUPREME COURT OF THE STATE OF OHIO
THE STATE OF OHIO, CITY OF COLUMBUS

CINCINNATI BELL TELEPHONE CO.,
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

APPEAL FROM THE PUBLIC UTILITIES COMMISSION

This cause, here on appeal from the Public Utilities Commission, was heard in the manner prescribed by law. On consideration thereof, the Order of the Public Utilities Commission is affirmed for the reasons stated in the opinion herein.

It is ordered that a mandate issue to the Public Utilities Commission to carry this judgment into execution.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

(Entered: July 25, 1983)

Case No. 83-392

IN THE SUPREME COURT OF OHIO

CINCINNATI BELL TELEPHONE COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Cincinnati Bell Telephone Company, the appellant named above, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Ohio, affirming that portion of the order of The Public Utilities Commission of Ohio which specifies the method by which Cincinnati Bell Telephone Company must calculate its depreciation costs and expenses. The final judgment of the Supreme Court of Ohio from which this appeal is taken was entered in this action on July 25, 1984.

This appeal is taken pursuant to 28 U.S.C. § 1257(1) and (2).

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Notice of Appeal to the Supreme Court of the United States was served upon all parties required to be served which includes counsel for appellee, The Public Utilities Commission of Ohio, Anthony J. Celebrezze, Attorney General of Ohio, Robert S. Tongren and Martin J. Marz, Assistant Attorney General, at 375 South High Street, Columbus, Ohio 43215, counsel for Intervenor, Office of Consumers' Counsel, William A. Spratley, Jannie L. Migden and Lawrence F. Barth at 137 East State Street, Columbus, Ohio 43215 and counsel for Amicus Curiae, J. Raymond Prohaska at Schneider, Prohaska & Sans, 906 East Broad Street, Columbus, Ohio 43205, by hand delivery, this 25th day of July, 1984.

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SEGMENTS OF CINCINNATI BELL TELEPHONE COMPANY'S BRIEF IN THE OHIO SUPREME COURT

(Entered: May 16, 1983)

Case No. 83-392

IN THE SUPREME COURT OF OHIO

CINCINNATI BELL INC.,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

Appeal from The Public Utilities Commission of Ohio

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* * * * *

III. STATEMENT OF FACTS

D. *FCC Preemption Order*

On January 6, 1983, the FCC released a Memorandum Opinion and Order (hereinafter referred to as the "FCC Preemption Order"), 48 Fed. Reg. 2324, whereby the FCC expressly decided the precise issue of federal preemption at issue in this action. A copy of the FCC Preemption Order is included in the separate Appendix to this brief as Exhibit E.

The proceedings in which the FCC Preemption Order was issued were commenced on June 7, 1982 upon the filing of two separate petitions with the FCC. The first was a petition for reconsideration of a prior FCC order relating to preemption which was filed by American Telephone and Telegraph Company ("AT&T") on behalf of itself and the associated Bell System Operating Companies (of which Cincinnati Bell is a member). FCC Preemtpion Order, ¶1. The second was a petition filed by General Telephone Company of Ohio ("GTE") requesting the FCC to preempt a prior PUCO order which had denied GTE the same depreciation rate as had been prescribed for it by the FCC. FCC Preemption Order, ¶12. Both the PUCO and the OCC participated in these proceedings before the FCC. FCC Preemption Order, ¶¶2 and 3.

The precise question presented for determination by the FCC in these proceedings was articulated by the FCC as follows:

> The question presented in the reconsideration petition is a clearly delineated controversy over whether Section 220(b) preempts state depreciation prescriptions that are inconsisted with the rates prescribed for classes of property by this Commission, or, whether

> Section 2(b)(1) or Section 221(b) reserve to the state the right to prescribe their own depreciation rates for intrastate regulatory purposes. [FCC Preemption Order, ¶9.]

In answering that question, the FCC expressly held that "the most logical and reasonable interpretation of Section 220(b) of the Act is that where the [FCC] prescribes depreciation rates for classes of property, state commisisons are precluded from departing from those rates." FCC Preemption Order, ¶44.

A Petition for review of the FCC Preemption Order subsequently was filed in the United States Court of Appeals for the Fourth circuit by the Virginia State Corporation Commission, Docket No. 83-1136. The PUCO, the OCC and Cincinnati Bell each is a party to that review proceeding. As of the time of filing of this brief, that review proceeding still is pending.

In the PUCO Initial Order released subsequent to the FCC Preemption Order, the PUCO specifically took judicial notice of and followed the FCC decision with respect to the issue of federal preemption of state-prescribed depreciation rates. PUCO Initial Order, page 19. Subsequently, however, in the PUCO Rehearing Order, the PUCO reversed itself and prescribed depreciation rates for Cincinnati Bell which differed from those prescribed by the FCC. PUCO Rehearing Order, page 3.

* * * * *

Proposition of Law No. 1:

WHEN THE ISSUE OF FEDERAL PREEMPTION OF STATE-PRESCRIBED DEPRECIATION RATES HAS BEEN DECIDED ADVERSELY TO THE PUCO IN AN ADMINISTRATIVE PROCEEDING TO WHICH THE PUCO WAS A PARTY, THE PUCO IS BOUND BY PRINCIPLES OF RES JUDICATA TO GIVE EFFECT TO THAT ADMINISTRATIVE DECISION.

It has long been settled in this jurisdiction that if an issue of fact or law actually is litigated and determined by a valid, final judgment, that determination is conclusively settled so far as the parties to that action and persons in privity with them are concerned. *E.g., Schimke v. Earley* (1962), 173 Ohio St. 521, 184 N.E.2d 209; *Hicks v. De La Cruz* (1977), 52 Ohio St. 2d 71, 369 N.E.2d 776. Under this aspect of the doctrine of *res judicata*, a party is said to be "collaterally estopped" from relitigating in a second action involving the same parties an issue raised in the first action. *Id.* This principle of collateral estoppel applies even if the first action was an administrative proceeding, so long as the administrative proceeding was of a judicial nature. *Superior's Brand Meats, Inc. v. Lindley* (1980), 62 Ohio St. 2d 133, 403 N.E.2d 996; *United States v. Utah Constr. & Mining Co.* (1966), 384 U.S. 394.

As is set out more fully in the Statement of Facts (*supra*, pages 5-7), in the instant case, Cincinnati Bell, the PUCO and the OCC all participated in a prior administrative proceeding before the FCC in which the precise preemption issue which is before the Court herein was litigated and decided. In the FCC Preemption Order entered in that proceeding the FCC held "that the most logical and reasonable interpretation of Section 220(b) of the Act is that where the [FCC] prescribes depreciation rates for

classes of property, *state commissions are precluded from departing from those rates.*" FCC Preemption Order, ¶44 (Emphasis added).

In the PUCO Initial Order issued in the Cincinnati Bell Rate Case, the PUCO specifically took administrative notice of the FCC Preemption Order. The PUCO further took administrative notice of a previous FCC order issued on December 14, 1982 in Docket No. 82-542 in which the FCC had prescribed the same remaining life accrual rates and equal life group accrual rates requested by Cincinnati Bell in the Cincinnati Bell Rate Case. PUCO Initial Order, page 19. Quite properly, the PUCO put those two binding FCC orders together and concluded in the PUCO Initial Order as follows:

> *In light of these two FCC decisions, and in the absence of any judicial determination to the contrary, this Commission feels compelled to adopt* [*Cincinnati Bell's*] *proposed depreciation rates.* The depreciation expense should, therefore, reflect the adoption of these represcribed remaining life and ELG accrual rates. If the [FCC Preemption Order] is overturned by a court of law, however, this Commission is willing to reconsider the matter, since we would have otherwise retained the whole life methodology in accordance with our prior decisions. [PUCO Initial Order, page 19 (Emphasis added)].

Subsequently, in the PUCO Rehearing Order, the PUCO inexplicably reversed itself and prescribed depreciation rates which differ from those prescribed for Cincinnati Bell by the FCC. PUCO Rehearing Order, page 3. In so reversing itself, the PUCO (1) openly defied the FCC Preemption Order, and (2) without explanation, reversed its previous position, expressed in the PUCO Initial Order, that it was *obligated* to follow the FCC Preemption

Order unless and until that order was overturned by a court of law.

In fact, the PUCO's initial position with regard to its obligation to follow the FCC Preemption Order is the position which is legally correct. In addition to the fact that the PUCO is bound under traditional principles of *res judicata*, the defiance by the PUCO of the FCC Preemption Order is in direct violation of federal law. Pursuant to §401 of the Communications Act, an FCC order which is regularly made and duly served is enforceable against anyone who fails or neglects to obey the order. 47 U.S.C. §401. The FCC Preemption Order was regularly made and was served on the PUCO along with all other state commissions. FCC Preemption Order, ¶49.

The proper means of challenging an FCC order is not by open defiance, but by the filing of a petition for review of that order in a United States Court of Appeals pursuant to 47 U.S.C. §402. *City of Peoria v. General Electric Cablevision Corp.* (7th Cir. 1982), 690 F.2d 116. Indeed, such a review proceeding with respect to the FCC Preemption Order currently is pending in the United States Court of Appeals for the Fourth Circuit in an action captioned *Virginia State Corporation Commission v. FCC,* Docket No. 83-1136. Both the PUCO and the OCC are parties to that review proceeding. While that review proceeding is pending, however, the FCC Preemption Order is still binding and effective, and the decision by the PUCO in the PUCO Rehearing Order to reverse itself on the federal preemption issue and relitigate the issue herein is nothing more than an impermissible collateral attack on the FCC Preemption Order. *Tacoma v. Taxpayers of Tacoma* (1958), 357 U.S. 320.

Such a collateral attack generally is said to be rendered impermissible by the doctrine of *res judicata*, but in

this situation the United States Supreme Court has noted that "[s]uch statutory finality need not be labeled res judicata, estoppel, collateral estoppel, waiver or the like by Congress or the Courts." *Id.* at pp. 336-337. The reason for this broader mandate of impermissibility, as applied to this case, is that neither the PUCO nor this Court has the jurisdiction to review the FCC Preemption Order and pass upon its merits. The United States Courts of Appeals have exclusive jurisdiction under the Communications Act and the Administrative Orders Review Act to review final orders of the FCC. *Compare* 47 U.S.C. §402(a) *with* 28 U.S.C. §2342; *City of Peoria v. General Electric Cablevision Corp.* (7th Cir. 1982), 690 F.2d 116. Thus, unless and until the FCC Preemption Order is overruled by the United States Court of Appeals for the Fourth Circuit, it still is a final and binding order not subject to collateral attack by the PUCO or the OCC, either in the PUCO Rehearing Order or in this Court.

In summary, the PUCO was correct in its first analysis of the federal preemption issue contained in the PUCO Initial Order. Until such time as the FCC Preemption Order is overruled by an appropriate court of law, the PUCO is legally obligated to follow and give effect to that order. It may not, on its own, effectively overrule that order (as it has tried to do in the PUCO Rehearing Order), and it may not ask this Court to collaterally overrule that order. Its sole recourse is to pursue its right of appeal in the United States Court of Appeals for the Fourth Circuit. Regardless of its ultimate outcome, while that review proceeding is pending, the FCC Preemption Order under review therein still is valid and binding.

It follows that this Court should find that the PUCO erred to the prejudice of Cincinnati Bell in the PUCO Rehearing Order when it failed to give effect to the FCC

Preemption Order and that the PUCO Rehearing Order thus is unlawful insofar as it purports to prescribe depreciation accrual rates for Cincinnati Bell which differ from those prescribed by the FCC.

Proposition of Law No. 2:

> WHEN COMPLIANCE BY A TELECOMMUNICATIONS CARRIER SUCH AS CINCINNATI BELL WITH BOTH FCC-PRESCRIBED DEPRECIATION RATES AND PUCO-PRESCRIBED DEPRECIATION RATES IS IMPOSSIBLE, THE PUCO-PRESCRIBED DEPRECIATION RATES ARE PREEMPTED BY THOSE OF THE FCC.

Even absent principles of res judicata, the Court must find, under well established judicial standards for determining the issue of federal preemption, that the FCC has preempted the PUCO's authority to prescribe depreciation rates inconsistent with those prescribed by the FCC. It has long been an established principle of constitutional law that the Supremacy Clause (Article VI, clause 2) of the Constitution of the United States mandates that federal law preempts state law where there is a conflict between the two. *E.g., McCulloch v. Maryland* (1819), 4 Wheat 316, 4 L. Ed 579; *Gibbons v. Ogden* (1824), 9 Wheat 1, 6 L. Ed 23. Thus where compliance with both federal and state law is effectively impossible, the state law must yield. *E.g., Florida Lime and Avocado Growers, Inc. v. Paul* (1963), 373 U.S. 132. In the instant case, the record evidences that there is such a preemptive conflict between the state and federal laws in question because compliance by Cincinnati Bell with both the FCC and PUCO orders relating to prescription of depreciation rates for Cincinnati Bell is impossible.

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SEGMENTS OF CINCINNATI BELL TELEPHONE COMPANY'S REPLY BRIEF IN THE OHIO SUPREME COURT

(Entered: September 12, 1983)

Case No. 83-392

IN THE SUPREME COURT OF OHIO

CINCINNATI BELL TELEPHONE COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

Appeal from The Public Utilities
Commission of Ohio

REPLY BRIEF OF APPELLANT

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* * * * *

3. *Rely to PUCO Proposition of Law No. III*

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In short, what took place before the FCC were two proceedings. The first involved a reconsideration of a prior FCC order involving generally the issue of pre-emption of state-prescribed depreciation rates. The second, however, involved a specific dispute between GTE of Ohio and the PUCO. It was a clearly delineated dispute involving the constitutional issue of pre-emption. No expert testimony or other evidence was required. The facts simply were not in dispute. The PUCO, however, had its opportunity to file comments and thereby present its legal arguments. It took full advantage of that opportunity. *See* FCC Preemption Order, ¶3; PUCO Brief, Page 39. Thus, with respect to the PUCO, the FCC Preemption Order was issued in a proceeding which adjudicated the rights of specific parties and was quasi-judicial in nature. Principles of res judicata thus are applicable.

This conclusion is bolstered by the fact that the FCC Preemption Order is now being reviewed by the United States Court of Appeals for the Fourth Circuit. The PUCO, the OCC and Cincinnati Bell are parties to that appeal. If the PUCO is not bound herein by the FCC Preemption Order under principles of res judicata and collateral estoppel, it could lead to two opinions being issued by different courts involving the same parties and the same order, but with diametrically opposite conclusions. For example, if this Court were to hold that the FCC cannot pre-empt a PUCO-prescribed depreciation rate and the Fourth Circuit were to hold that the FCC can, Cincinnati Bell (as well as the PUCO and the OCC) would be subject to two valid, but diametrically opposed orders. A finding by this Court that the PUCO is bound under

principles of res judicata to comply with the FCC Preemption Order unless and until the Fourth Circuit rules otherwise would eliminate this risk of conflicting and confusing orders and would be fully consistent with the salutary principles underlying res judicata.[8]

* * * * *

First, Cincinnati Bell has established that in a quasi-judicial administrative proceeding to which the PUCO was a party, the FCC held, among other things, that the PUCO was preempted from prescribing depreciation methods which differ from those prescribed by the FCC. That FCC Preemption Order has been appealed to the United States Court of Appeals for the Fourth Circuit. That appeal still is pending. Unless and until it is reversed, it is binding upon the PUCO under principles of res judicata and collateral estoppel. The attempt by the PUCO to argue herein that the FCC wrongfully decided the FCC Preemption Order is nothing more than an impermissible collateral attack on an order which is not subject to review by this Court. Accordingly, under principles of res judicata and collateral estoppel, this Court should reverse the PUCO Rehearing Order and order the PUCO to prescribe the same depreciation methods for Cincinnati Bell as those prescribed by the FCC unless and until the FCC Preemption Order is reversed on appeal by the Fourth Circuit or the Supreme Court of the United States.

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8. It should be pointed out that a prior ruling by this Court would not be fully dispositive of the Fourth Circuit appeal because there are numerous other parties to that appeal (not the least of which is the FCC) who are not parties to this proceeding and thus would not be bound by it. Thus, although all of the parties to this proceeding would be bound by a decision of the Fourth Circuit, the converse is not true. This is another reason to apply principles of res judicata to the FCC Preemption Order.

LETTER FROM MARK H. LONGENECKER, JR. TO JAMES KELLY, CLERK OF THE OHIO SUPREME COURT

FROST & JACOBS

2500 Central Trust Center
201 East Fifth Street
Cincinnati, Ohio 45202
(513) 651-6944
June 19, 1984

James Wm. Kelly
Clerk, The Supreme Court of Ohio
30 East Broad Street
Columbus, Ohio 43215

Re: Cincinnati Bell Telephone Company v. The Public Utilities Commission of Ohio, et al., Case No. 83-392

Dear Mr. Kelly:

Among the primary issues pending before the Supreme Court in the above-referenced action is one relating to depreciation methodology and the obligation of The Public Utilities Commission of Ohio to comply with a certain order of the Federal Communications Commission preempting inconsistent state-prescribed depreciation methodologies. An action challenging the validity of that FCC Preemption Order has been pending before the United States Court of Appeals for the Fourth Circuit. Yesterday the Fourth Circuit decided that action, holding that the FCC has jurisdiction to preempt inconsistent state-prescribed depreciation methodologies. A copy of that decision is enclosed with this letter.

We believe that the enclosed decision of the Fourth Circuit is dispositive of the depreciation issues pending before the Supreme Court in the above-referenced action. Accordingly, we respectfully request that you inform the Court of the outcome of the Fourth Circuit action.

Thank you again for your co-operation and assistance in this matter.

Very truly yours,

/s/ MARK H. LONGENECKER, JR.
Mark H. Longenecker, Jr.

DCH/maj
Enclosures
cc: Counsel of Record (w/encl.)